

REPLACING HOSTILE TAKEOVERS

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INTRODUCTION

The displacement of inefficient managers ranks among the chief problems of corporate law. Inefficient managers underutilize corporate assets, erode shareholder wealth, and reduce the share price of the corporation's common stock. In theory, shareholders' remedy for inefficient management is to elect new directors who will displace them and operate the corporation more efficiently, driving its stock price higher. In practice, however, managers' control over the proxy machinery and the shareholders' collective action problems make voting inefficient management out of office virtually impossible.

The fallback remedy has been the hostile takeover. In a hostile takeover, a bidder perceives that the target corporation's value under incumbent management is less than it could be in the bidder's hands. The bidder purchases a controlling block of the target corporation's stock at a substantial premium above the then market price, installs its own board of directors, and squeezes out any remaining shareholders through a second-step, cash-out merger.

Takeovers provide shareholders with a better return on their investment than they would have received had incumbent management remained in control. The takeover (or "control") premium compensates the target's shareholders for much of their loss due to the incumbent management's inefficiency. The possibility of takeover pressures managers of other corporations to maximize shareholder value.

The primary disadvantage of takeovers is that they place shareholders at the mercy of other persons—either the bidder or incumbent management. Specifically, takeovers can force shareholders to tender their shares even when they value the shares more than the tender offer price.¹ Two-tiered, front-end-loaded take-

¹ Such takeovers arguably distort the choice of securityholders; resisting the offer necessarily places the unwilling participant in a potentially worse position than if she tendered. For example, shareholders who "vote against" accepting a tender offer by not tendering do not have their shares purchased and thus are exposed to receiving inferior consideration for their shares in a second-step, squeeze-out merger. The most elegant theoretical solution to these strategic disadvantages involves allowing the securityholder both to vote against the transaction and, in case her side loses, to participate in the transaction as if she had supported it. See Lucian A. Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693, 1747-50 (1985) (describing various ways bidders can force shareholders to tender even when shareholders consider the offer price to be lower than the target's intrinsic value and proposing a regime that allows shareholders to vote on approving

overs confront dispersed shareholders with a "prisoner's dilemma"—unless they tender, they can be squeezed out of their equity ownership later at a lesser price. Thus, opponents of takeovers claim, shareholders do not tender voluntarily.²

On the other hand, sophisticated takeover defenses currently block shareholders from selling to bidders, even when they wish to do so.³ Shareholders remain at the mercy of managers, who can remove the market's most serious constraints on managerial

the tender offer and to tender and have their shares purchased in a successful tender offer even if they have voted against the tender offer). Unfortunately, under current law, takeovers do not provide shareholders with such protections. Dissolution, on the other hand, by its structure, inherently does. See *infra* notes 5-8 and accompanying text (explaining how dissolution compels the implication of *Revlon's* auction duties).

Experts have vigorously contested the claim that takeovers are coercive. See Michael Bradley, Anand Desai & E. Han Kim, *Synergistic Gains from Corporate Acquisitions and Their Division Between the Stockholders of Target and Acquiring Firms*, 21 J. FIN. ECON. 3, 32-37 (1988) (creating a theoretical model allowing managers to structure a self tender that will always dominate an attempt to acquire the target below its pre-offer market value); see also FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 180-81 (1991) (describing ways to defeat coercive bids).

To "protect" shareholders from exploitation, managers employed takeover defenses, which not accidentally also shielded themselves, driving up the premiums required to dislodge them. See, e.g., *id.* at 172-73 (noting that market forces exist that can prevent bidders from coercing shareholders into tendering prematurely); John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1206 (1984) (concluding that substantial takeover premiums will persist, even if regulatory constraints are relaxed, and that such premiums will place a severe limitation on the theory of the takeover as a "comprehensive corrective of managerial inefficiency").

² Experts sometimes tout proxy contests as a less coercive alternative to takeovers because they do not create prisoner's dilemma problems. Even if the dissident slate gains control of the board, the dissidents do not thereby cause some shareholders to exit the corporation under conditions that disadvantage other shareholders. Consequently, proxy contests do not put shareholders in any strategic disadvantage.

Collective action problems, however, render proxy contests generally ineffectual for disciplining management. Economic incentives make the proxy fight uneconomical for most dissidents, even if they have correctly perceived significant erosion in shareholder value. In addition, the nature of a proxy fight invites rational apathy by shareholders. Unlike the tender offer, which provides a single offered share price which stands in stark contrast with the pre-takeover price, a proxy contest confronts shareholders with huge informational burdens. Shareholders must sift through competing election materials to decide which group of nominees will best run the company. The complexity of such a decision creates inertia that favors the incumbents. Knowing that one's decision will not tip the balance of the contest, most shareholders remain uninvolved and doom most proxy fights to failure.

For brief, clear discussion of collective action problems and citations to recent literature, see Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with the Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 908-11 (1993).

³ See *infra* note 25.

inefficiency and, in effect, entrench themselves.

This Article will demonstrate that voluntary dissolution can and should replace hostile takeovers as the preferred means to oust inefficient corporate management. In a voluntary dissolution, shareholders of the subject corporation ("S") holding a specified percentage of stock would initiate a vote to dissolve the corporation. If holders of a majority of the shares⁴ vote to dissolve S, the law would require the board to obtain the highest value by auctioning the corporation. Such auctions will almost always produce substantial premiums for S shareholders.

Voluntary dissolution provides all of the benefits of the takeover, while avoiding all of its harms. First, dissolution does not expose shareholders to the prisoner's dilemma. If holders of sufficient shares vote to dissolve, dissenting shareholders still receive a pro rata share of the proceeds; they are not treated discriminatorily or otherwise exploited.⁵ If the initiative fails, no dissolution will occur, and S's stock price should resume trading at its pre-vote level. Consequently, shareholders will vote for voluntary dissolution only when they genuinely wish to force an auction.

Second, voluntary dissolution circumvents takeover defenses. At the corporate level, voluntary dissolution triggers an auction of the corporation.⁶ The duty of the S board shifts from managing S's ongoing business to getting the best price for the stockholders at a sale of the company.⁷ Getting the best price necessitates that the

⁴ Some states require a simple, affirmative majority to approve dissolution; others require a supermajority. Among states that already permit shareholders to initiate dissolution, California requires holders of an affirmative majority of the stock to approve dissolution; New York and Illinois require holders of two-thirds of the stock to approve dissolution. See *infra* part IV.A.1 (discussing shareholder powers to initiate dissolution).

⁵ Indeed, if any shareholders are discriminated against, they can sue in equity to block the transaction. See *infra* note 127 and accompanying text (discussing the law's intervention to protect minority shareholders).

⁶ Put differently, dissolution enables shareholders to trigger *Revlon's* auction duties. In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), the Delaware Supreme Court enunciated the rule that when the break-up of the company becomes inevitable and/or the company is for sale, the duty of the board of directors changes "from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company." *Id.* at 182. In its *Time-Warner* decision, the Delaware Supreme Court reiterated that dissolution triggers *Revlon* duties. See *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140, 1150-51 (Del. 1989) (holding that, because there was no evidence that "the dissolution or break-up of the corporate entity [was] inevitable," no *Revlon* duties arose).

⁷ See *Revlon*, 506 A.2d at 182 ("The duty of the board had thus changed from the

board redeem any poison pill in order to accept the winning bid. State anti-takeover statutes consistently permit management to accept "friendly" bids. Since the auction's winning bid will have been invited by shareholder-initiated dissolution, by definition it will be friendly. Management must approve the best bid, and this approval will disarm all the anti-takeover laws' potentially negative consequences.⁸

Third, dissolution will discipline managers sooner than takeovers, thus reducing impairment of shareholder wealth and disruption to non-shareholder constituencies. Dissolution will enable shareholders to trigger an auction and displace inefficient managers well before occurrence of the major erosion of shareholder value normally required before bidders launch takeovers. In addition, dissolution will empower shareholders to accept whatever sized premiums they choose, making it more likely that shareholders will accept smaller premiums than management would otherwise force bidders to pay.⁹

Fourth, dissolution frees shareholders from having to rely on bidders identifying and pursuing takeover targets. Dissolution allows public shareholders to initiate an auction even before a bidder has surfaced. As such, dissolution would be a kind of servomechanism that automatically disciplines managerially-created losses of value.

Finally, as I demonstrate elsewhere,¹⁰ in addition to its superi-

preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit.").

⁸ Thus, dissolution allows the company's takeover defenses to be penetrated, but only from "the inside," i.e., by the shareholders, thereby avoiding the opposing threats of management entrenchment and bidder opportunism that have driven some commentators to espouse abandoning market solutions for regulatory ones. See, e.g., Coffee, *supra* note 1, at 1250-64 (recommending regulation of takeover battles to protect shareholders from both managers and bidders). Dissolution would stop preclusive takeover defenses from reducing shareholder wealth, because the combination of dissolution and preclusive defenses vests the decision to sell the company exclusively in shareholders' hands.

⁹ See, e.g., Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 601 (1989) (noting that management resistance precluded shareholders from being able to accept generous premiums of 30% and made premiums of upwards of 50% necessary). By allowing a majority of shareholders to implicitly set a lower reservation price when they initiate an auction, dissolution will increase the number of companies disciplined without risking shareholder exploitation.

¹⁰ See Park McGinty, *Mastering the Servant: Using Voluntary Dissolution As Shareholder Self Help for Protecting Shareholders from Their Agents* (1995) (unpublished manuscript, on file with author) [hereinafter *Mastering the Servant*]; Park McGinty, *Reforming the Appraisal Remedy* (1995) (unpublished manuscript, on

ority to hostile takeover as a method for redeploying corporate assets, voluntary dissolution would provide effective protections against acute managerial opportunism, against inefficient business combinations—such as the merger between Time, Inc. and Warner Communication, Inc.¹¹—that preclude shareholders from more wealth-producing transactions, and against inadequate compensation in corporate freezeouts by majority shareholders.

The rest of this Article comprises six parts. Part I explains the current need for a mechanism to replace inefficient management. Part II compares the use of involuntary judicial dissolution in the close corporation with the use of voluntary dissolution in the public corporation. Part III explains how dissolution would work as a business matter, while Parts IV and V explain how dissolution would work under state corporate law and federal securities law, respectively. Although most states do not provide shareholders a realistic ability to initiate voluntary dissolution in spite of board opposition,¹² a surprisingly substantial number of states do provide such

file with author).

¹¹ For description of the facts of the case, see *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989); *In re Time Inc. Shareholders Litig.*, Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. 1989). For extended analysis, see *Mastering the Servant*, *supra* note 10.

¹² For present purposes, statutes that require boards to initiate a dissolution vote come in two basic forms. The first form explicitly vests exclusive power to initiate dissolution proceedings in the board. The second form allows shareholders to initiate dissolution but requires unanimous shareholder approval. (All such jurisdictions provide that the board can initiate dissolution, with shareholder approval necessary.) Because managers of public companies will inevitably own some shares of their companies, in such jurisdictions, board-initiated dissolution will be the only realistic method of dissolution. (In the following citations, states that allow unanimous shareholder approval are marked with an asterisk. The first statutory provision listed is that which authorizes the board to initiate approval; the second is that which grants the unanimous shareholder right.)

See the statutes of Alabama* [ALA. CODE § 10-2B-14.02(f) (1994); ALA. CODE § 10-2B-14.02(f) (1994)]; Arizona* [ARIZ. REV. STAT. ANN. § 10-084(1) (1990), *repealed by* 1994 Ariz. Sess. Laws, ch. 223, § 3 (effective Jan. 1, 1996); ARIZ. REV. STAT. ANN. § 10-083(1) (1990), *repealed by* 1994 Ariz. Sess. Laws, ch. 223, § 3 (effective Jan. 1, 1996)]; Colorado [COLO. REV. STAT. § 7-114-102(2)(b) (1995)]; Connecticut [CONN. GEN. STAT. ANN. § 33-376(c) (West 1987), *repealed by* 1994 Conn. Acts 94-186, § 214 (effective Jan. 1, 1997)]; Delaware* [DEL. CODE ANN. tit. 8, § 275(a) (1991); DEL. CODE ANN. tit. 8, § 275(c) (1991)]; Georgia [GA. CODE ANN. § 14-2-1402(b)(1) (1994)]; Hawaii* [HAW. REV. STAT. § 415-84(1) (1992); HAW. REV. STAT. § 415-83 (1992)]; Idaho* [IDAHO CODE § 30-1-84 (1980); IDAHO CODE § 30-1-83 (1980)]; Indiana [IND. CODE ANN. § 23-1-45-2(b)(1) (Burns 1976), *amended by* IND. CODE ANN. § 23-1-45-2(b)(1) (Burns 1995) (effective July 1, 1996)]; Iowa [IOWA CODE ANN. § 490.1402(2)(a) (West 1991)]; Kansas [KAN. STAT. ANN. § 17-6804(a) (1988)]; Kentucky [KY. REV. STAT. ANN. § 271B.14-020(2)(a) (Michie/Bobbs-Merrill 1989)]; Maryland [MD. CODE

a right.¹³ For simplicity, Part IV will restrict itself to analyzing the corporate law of the three most important commercial jurisdictions outside Delaware: New York, California, and Illinois. Finally, Part VI suggests a mechanism whereby shareholders can vote to forgo dissolution for five-year periods, thereby minimizing unnecessary monitoring costs.

I. THE CURRENT NEED FOR A MECHANISM TO REPLACE INEFFICIENT MANAGEMENT

Traditionally, corporate law delegates to the board of directors the power to manage the corporation because such delegation is efficient. According to the standard view, shareholders specialize in bearing the risk of their investment, and management specializes in running the corporation's affairs. Consequently, shareholders in American corporations have very few positive rights. They do,

ANN., CORPS. & ASS'NS § 3-403(b)(1) (1993)]; Michigan [MICH. STAT. ANN. § 21.200(804)(3) (Callaghan 1988)]; Mississippi [MISS. CODE ANN. § 79-4-14.02(b)(1) (1989)]; Missouri* [MO. ANN. STAT. § 351.464(2)(1) (Vernon 1991); MO. ANN. STAT. § 351.466 (Vernon 1991)]; Montana [MONT. CODE ANN. § 35-1-932(2)(a) (1993)]; Nebraska* [NEB. REV. STAT. § 21-2083(1) (1991); NEB. REV. STAT. § 21-2082 (1991)]; Nevada [NEV. REV. STAT. § 78.580(1) (1993)]; New Hampshire [N.H. REV. STAT. ANN. § 293-A:14.02(b)(1) (1994)]; New Jersey* [N.J. STAT. ANN. § 14A:12-4(2) (West 1988); N.J. STAT. ANN. § 14A:12-3 (West 1988)]; New Mexico* [N.M. STAT. ANN. § 53-16-3 (Michie 1993); N.M. STAT. ANN. § 53-16-2 (Michie 1993)]; North Carolina [N.C. GEN. STAT. § 55-14-02(b)(1) (1990)]; Oklahoma [OKLA. STAT. ANN. tit. 18, § 1096(A) (West 1995)]; Oregon* [OR. REV. STAT. § 60.624 (1993); OR. REV. STAT. § 60.624 (1993)]; Pennsylvania [15 PA. CONS. STAT. § 1972(a) (1995)]; Rhode Island* [R.I. GEN. LAWS § 7-1.1-77(1) (1992); R.I. GEN. LAWS § 7-1.1-76(a) (1992)]; South Carolina [S.C. CODE ANN. § 33-14-102(b)(1) (Law. Co-op. 1990)]; South Dakota [S.D. CODIFIED LAWS ANN. § 47-7-4.1(1) (1991)]; Tennessee* [TENN. CODE ANN. § 48-17-104(c)(1) (1995); TENN. CODE ANN. § 48-17-104(a) (1995)]; Texas* [TEX. BUS. CORP. ACT ANN. art. 6.03(A)(1) (West 1996); TEX. BUS. CORP. ACT ANN. art. 6.02(A) (West 1980)]; Utah [UTAH CODE ANN. § 16-10a-1402(2)(a) (1995)]; Vermont [VT. STAT. ANN. tit. 11A, § 14.02(b)(1) (1993)]; Virginia [VA. CODE ANN. § 13.1-742(B)(1) (Michie 1993)]; Washington [WASH. REV. CODE ANN. § 23B.14.020(2)(a) (West 1994)]; West Virginia* [W. VA. CODE § 31-1-126(a) (1988); W. VA. CODE § 31-1-125 (1988)]; Wisconsin [WIS. STAT. ANN. § 180.1402(1)(a) (West 1992)]; Wyoming [WYO. STAT. § 17-16-1402(b)(i) (1989)].

¹³ See ALASKA STAT. § 10.06.605 (1989); ARK. CODE ANN. § 4-26-710 (Michie 1987); CAL. CORP. CODE § 1900(a) (West 1990); FLA. STAT. ANN. § 607.1402(6) (West 1993); ILL. ANN. STAT. ch. 805, para. 5/12.15 (Smith-Hurd 1992); LA. REV. STAT. ANN. § 12:142A (West 1994); ME. REV. STAT. ANN. tit. 13-A, § 1103(1)(A)(2) (West 1988); MASS. GEN. LAWS ANN. ch. 156, § 100(a) (West 1992); MINN. STAT. ANN. § 302A.721(2)(a) (West 1985); N.Y. BUS. CORP. LAW § 1001 (McKinney 1986); N.D. CENT. CODE § 10-19.1-107 (1995); OHIO REV. CODE ANN. § 1701.86(E) (Anderson 1992).

however, enjoy the essential authority to elect directors and to sell their shares.

Experts have traditionally characterized public corporation shareholders as capable of escaping managerial oppression by selling their stock in liquid securities markets.¹⁴ However, markets discount the firm's shares to the extent that managerial underperformance destroys wealth. Thus, the public shareholder may escape by selling, but if no one constrains management from decreasing firm value, the selling shareholder may be largely shorn of the value of her investment.

As recognized as early as 1963,¹⁵ hostile takeovers or, more formally, the market for corporate control has played a central role in reducing agency costs when shareholders are too dispersed to discipline management directly. Hostile takeovers played an active role through the 1970s and 1980s. Through the mid-1980s, a fully financed and determined bidder that had purchased a substantial block of target company stock could expect to see the target taken over. The bidder would profit whether it or another bidder acquired the target corporation or whether the target restructured itself so as to maximize share value.¹⁶ Shareholders would receive

¹⁴ Indeed, important commentators have argued that it is solely the illiquidity of close corporations that allows insiders to exploit minority shareholders. See, e.g., J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1 (1977) (proposing that exploitation is uniquely related to illiquidity); Terry A. O'Neill, *Self-Interest and Concern for Others in the Owner-Managed Firm: A Suggested Approach to Dissolution and Fiduciary Obligation in Close Corporations*, 22 SETON HALL L. REV. 646, 663-77 (1992) (distinguishing public corporation shareholders from close corporation shareholders largely on the basis of the formers' ability to sell shares on the market when dissatisfied); Ralph A. Peeples, *The Use and Misuse of the Business Judgment Rule in the Close Corporation*, 60 NOTRE DAME L. REV. 456, 462 (1985) (noting that "judicial deference to managerial decisions is based on an assumption of stock liquidity").

¹⁵ The earliest accounts of the market for corporate control in the economic literature are Robin Marris, *A Model of the "Managerial" Enterprise*, 77 Q.J. ECON. 185, 189-90 (1963) (describing the mechanism by which inefficient management is more likely to be the subject of a takeover), and in the legal literature, Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965) (describing how the takeover market allows more efficient managers to purchase target stock at depressed prices and extract more value from the target).

¹⁶ See, e.g., Harry DeAngelo & Linda DeAngelo, *Proxy Contests and the Governance of Publicly Held Corporations*, 23 J. FIN. ECON. 29, 30, 51-52 (1989) (finding that dissident activity typically increases shareholder wealth, especially where it leads to the sale or liquidation of the company). Indeed, DeAngelo and DeAngelo found that fewer than one fifth of sample firms that were targets of proxy fights during the period 1978-1985 remained independent public companies managed by the same persons three years after a proxy fight. See *id.* at 52.

a premium, and underutilized assets would move to higher valued uses. On balance, takeovers significantly benefitted society, yielding huge premiums to target shareholders and leading to a resurgence of American productivity.¹⁷

Towards the end of the 1980s, however, corporations increasingly employed new takeover defenses that effectively prevented target shareholders from selling their shares to a bidder without incumbent management's approval.¹⁸ At the corporation level,

¹⁷ For reviews of the evidence that takeovers generally benefitted society, see FRANK R. LICHTENBERG, *CORPORATE TAKEOVERS AND PRODUCTIVITY* 127-33 (1992) (concluding that takeovers in the 1980s reversed an earlier, inefficient trend towards diversification and, by intensifying corporate focus on core business, increased productivity); Bernard S. Black & Joseph A. Grundfest, *Shareholder Gains from Takeovers and Restructurings Between 1981 and 1986: \$162 Billion Is a Lot of Money*, J. APPLIED CORP. FIN., Spring 1988, at 5, 5 (estimating that between 1981 and 1986 shareholders gained at least \$162 billion from takeovers of public corporations, divestitures, and leveraged recapitalizations and that such takeovers helped fuel the contemporaneous rapid growth in manufacturing productivity); James A. Brickley & Leonard D. Van Drunen, *Internal Corporate Restructuring: An Empirical Analysis*, 12 J. ACCT. & ECON. 251, 253 (1990) (finding that restructurings by underperforming firms to increase efficiency result in increased share prices even when short-term operating results are negative, suggesting that the stock market does not pressure managers to adopt a short-term perspective); Grundfest, *supra* note 2, at 869-73; Gregg A. Jarrell, James A. Brickley & Jeffrey M. Netter, *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSP. 49, 58 (1988) ("We therefore conclude that evidence is consistent with the notion that these corporate transactions reflect economically beneficial reshufflings of productive assets."); Michael C. Jensen, *Corporate Control and the Politics of Finance*, J. APPLIED CORP. FIN., Spring 1991, at 13, 15 (noting productivity gains from takeovers and estimating that during the period 1976-1990 target shareholders received approximately \$650 billion in takeover premiums); Michael C. Jensen, *Takeovers: Their Causes and Consequences*, 2 J. ECON. PERSP. 21, 26-28 (1988) [hereinafter, Jensen, *Takeovers*]; Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 9, 22 (1983) (finding that target firm shareholders experience large gains, bidding firm shareholders do not lose, and gains do not come from increased market power in violation of antitrust laws); Roberta Romano, *A Guide to Takeovers: Theory, Evidence, and Regulation*, 9 YALE J. ON REG. 119, 122-25 (1992) (interpreting economics and finance literature to find that takeovers increase social wealth with no comparable offsetting losses to non-shareholder constituencies); Andrei Shleifer & Robert W. Vishny, *The Takeover Wave of the 1980s*, 249 SCIENCE 745, 747 (1990) (dismissing common objections to takeovers); cf. Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. FIN. 831, 837, 850 n.30 (1993) [hereinafter Jensen, *Modern Industrial Revolution*] (updating an estimate of the amount of target shareholder gains received during the years from 1976-1990 to \$750 billion in 1992 dollars and listing 43 studies since 1984 confirming that public corporations' internal control systems have failed to cause management to maximize efficiency and value).

¹⁸ See, e.g., Grundfest, *supra* note 2, at 858-65 ("The takeover wars are over. Management won.").

shareholders' rights plans, or "poison pills," made hostile takeovers prohibitively expensive.¹⁹ Most states also enacted effective anti-takeover legislation.²⁰ While hostile takeovers do occur, in comparison to the 1980s, they are rare and, thus, no longer pose the same disciplinary threat to management.

Today, management can normally prevent any unsolicited takeover it disfavors (and, most likely, it disfavors them all). Courts have only rarely nullified management's decisions and intervened to enable shareholders to obtain generous takeover premiums.²¹ Indeed, in *Paramount Communications, Inc. v. Time Inc.*,²² the Delaware Supreme Court signalled a willingness to allow management to block hostile takeovers, no matter how generous the premium.²³ Management can thus hold hostage the corporation's value, including any takeover premium that might be offered to shareholders.²⁴ Public shareholders, thus, now resemble close corporation shareholders in being trapped by those controlling the firm from exiting the corporation at something approaching their pro rata share of the corporation's full value, even where holders of over ninety percent of the shares want to sell.²⁵ Because manage-

¹⁹ See *infra* notes 176-77 and accompanying text (discussing how a poison pill inflicts intolerable economic loss on any bidder who triggers the flip-over or flip-in rights).

²⁰ See *infra* notes 181-84 and accompanying text (discussing state anti-takeover statutes); John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425, 1440-52 (1991) (describing various anti-takeover statutes as of 1991).

²¹ See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 798 (Del. Ch.) (holding that a mild "threat to shareholders' economic interests" from noncoercive stock offer did not justify effectively foreclosing shareholders from accepting offer through use of defensive poison pill rights), *appeal dismissed*, 556 A.2d 1070 (Del. 1988); *Grand Metro. Pub. Ltd. v. Pillsbury Co.*, 558 A.2d 1049 (Del. Ch. 1988) (forcing board to redeem pill because the board's decision to keep poison pill in place, thereby precluding shareholders from accepting tender offer, was disproportional to the threat).

²² 571 A.2d 1140 (Del. 1989).

²³ See Jonathan J. Lerner, *Did the Time Decision Torpedo the Hostile Bid?*, MERGERS & ACQUISITIONS, Jan.-Feb. 1990, at 41, 41 (discussing the impact of the *Time-Warner* case); Stephen J. Massey, *Chancellor Allen's Jurisprudence and the Theory of Corporate Law*, 17 DEL. J. CORP. L. 683, 757-68 (1992) (describing the later evolution of Delaware case law on the proportionality standard of *Unocal Corp. v. Mesa Petroleum Corp.*, from *Interco* to its evisceration in *Time-Warner*).

²⁴ For the case that hostile takeovers are virtually impossible, see *Grundfest*, *supra* note 2, at 857-64.

²⁵ See, e.g., Michael Quint, *Interco Bars Negotiations on Rales Bid: Company Says It'll Push Own Revamping Plan If Offer Is Withdrawn*, N.Y. TIMES, Nov. 15, 1988, at D4 (reporting that, nearly 9% of Interco's shares having already been voluntarily sold to

ment often treats non-management public shareholders the same way that controlling shareholders treat minority shareholders in close corporations, this Article will sometimes refer to these non-management public shareholders as "minority shareholders."

In the search for a new, non-takeover mechanism to discipline management, some commentators have focused on increased activism by institutional shareholders.²⁶ These commentators cite the apparent monitoring success of large shareholders in Japanese and German corporations²⁷ or other foreign governance mecha-

the bidder, an additional 84% was tendered, amounting to 93% of Interco's stock; but, using the preclusive poison pill takeover defense, Interco management still resisted the bidder's offer as "inadequate"); see also *Pillsbury*, 558 A.2d at 1058 (reporting that approximately 87% of Pillsbury's shares were tendered into the bidder's tender offer, which Pillsbury management, using the preclusive poison pill takeover defense, still resisted as "inadequate").

Without court action, shareholders would have been precluded from selling their shares. Although courageous decisions by Delaware's Chancery Court forced redemption of the preclusive takeover defenses in the two cases mentioned, it is doubtful that the Delaware Supreme Court would reach the same result. See *Time-Warner*, 571 A.2d at 1153.

To the extent that the Court of Chancery has recently [determined that precluding shareholders from being able to sell their shares for a 59% premium over the pre-bid price was not proportional to the threat of shareholders receiving inadequate value in the bidder's non-coercive tender offer] in certain of its opinions, we hereby reject such approach as not in keeping with a proper *Unocal* analysis.

Id.

²⁶ See, e.g., Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 827 (1992) (recommending expanding the role of institutional shareholders); Alfred F. Conard, *Beyond Managerialism: Investor Capitalism?*, 22 U. MICH. J.L. REF. 117, 163 (1988) (recommending lessening constraints hindering institutional investors and their increased activism); George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 923 (recommending that proxy solicitations be vested exclusively in a committee of the corporation's 10 or 20 largest shareholders); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 875, 904 (1991) (recommending that boards include a cadre of professional independent directors in the separate pay of institutional shareholders).

²⁷ See generally Bernard S. Black, *The Value of Institutional Investor Monitoring: The Empirical Evidence*, 39 UCLA L. REV. 895 (1992) (discussing the implications of comparative corporate governance analysis); Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871 (1993) (describing the Japanese keiretsu system as an alternative corporate governance and industrial organizational form and noting that it has not yet proved itself as an effective substitute for takeovers); Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927 (1993) (discussing how the three countries' organization of financial intermediaries and politics interact with and shape different corporate

nisms.²⁸ In addition, independent directors have grown more prominent and have exerted more forceful oversight of laggard corporations.²⁹ Finally, constructive legal deregulation may facilitate management discipline. Numerous commentators have noted the perverse effects on American corporate governance of laws and regulations that foreclose larger shareholders from monitoring their agents more effectively.³⁰ Congress and the SEC are removing some of these obstacles to monitoring.

Although many of the suggested reforms warrant support, they may well fall short of effective management discipline. Even when institutional investors admit wanting to influence management, they consistently disclaim any intention to influence the direction of the corporation's day-to-day business³¹ and focus instead on certain structural or procedural matters, such as anti-takeover defenses,³² reform of proxy regulations, and confidential voting.³³ Only rarely

governance paradigms).

²⁸ See Ronald J. Gilson & Reinier Kraakman, *Investment Companies As Guardian Shareholders: The Place of the MSIC in the Corporate Governance Debate*, 45 STAN. L. REV. 985, 997 (1993) (using Swedish investment company monitoring as a model for active large shareholder involvement in corporate governance).

²⁹ See Grundfest, *supra* note 2, at 880-900 (providing illuminating case histories of four recent turnovers of underperforming managers); see also John W. Byrd & Kent A. Hickman, *Do Outside Directors Monitor Managers?: Evidence from Tender Offer Bids*, 32 J. FIN. ECON. 195, 201-05 (1992) (indicating that a substantial percentage of independent directors (optimally 40%-60%) improve managers' performance, for example, in making acquisitions).

³⁰ See, e.g., Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 585, 608 (1990) ("[L]egal barriers, manager agenda control, and conflicts of interest may be important reasons why shareholders do as little as they do."); Joseph A. Grundfest, *Subordination of American Capital*, 27 J. FIN. ECON. 89, 110, *passim* (1990) (describing how "[l]egislators and regulators can generate, exacerbate, and reallocate the costs and benefits associated with agency problems for the benefit of politically favored constituencies"); Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 65 (1991) [hereinafter Roe, *A Political Theory*] (arguing that the legal system has limited control by financial institutions and that the restrictions imposed by the legal system have a political explanation); Mark J. Roe, *Takeover Politics*, in THE DEAL DECADE: WHAT TAKEOVERS AND LEVERAGED BUYOUTS MEAN FOR CORPORATE GOVERNANCE 321, 322 (Margaret M. Blair ed., 1993) (noting that, because Congress encouraged investment by small, scattered investors, none had enough incentive or means to see that the firm was well run).

³¹ See Black, *supra* note 26, at 834 (noting that institutional investors "appear to understand that they can't micromanage individual companies").

³² See John Pound, *Where Shareholder Activism Is Paramount*, WALL ST. J., Dec. 7, 1993, at A16 (describing institutional investors' forcing a resistant CEO to consider negotiations with an unsolicited bidder that the CEO had originally spurned).

³³ See generally Black, *supra* note 26, at 834-39 (noting ways in which institutional investors can increase value to companies they own without micromanaging); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79

do they challenge management on corporate strategy.³⁴ Management's ability to withhold business and thus to pressure fund managers to benefit management, rather than shareholders, further undermines the possibility of radically improved institutional shareholder monitoring.³⁵

GEO. L.J. 445, 481-90 (1991) (discussing shareholder activism as measured by shareholder resolutions in the form of takeover-related proposals and confidential voting). Both Black and Rock carefully set forth the conflicts of interest and the absence of aligned incentives between money managers and their beneficiaries that make successful disciplining seem unlikely, apart from exceptionally focused issues such as takeover defenses and decisions whether to continue with derivative suits. Black is more optimistic than Rock that monitoring reforms can be effectively expanded. See Black, *supra* note 26, at 834-35; Rock, *supra*, at 489.

³⁴ See Black, *supra* note 26, at 839. While encouraging the trend toward more active oversight, prominent business law practitioners have warned that the more that independent directors try to monitor ongoing business, as opposed to structural issues like takeover defenses, the greater the legal liability they may face for violating their duty of care. See Dennis J. Block & Jonathan M. Hoff, *Corporate Governance Reform and Directors' Duty of Care*, N.Y. L.J., May 20, 1993, at 5, 6 ("The business judgment rule, moreover, is less likely to shield directors from breach of the duty of care in the monitoring context.").

³⁵ Overt conflicts of interest face fund managers who expect to do collateral business with a corporation (for example, insurance companies that wish to sell insurance to a corporation or commercial or investment banks that wish to lend money to a corporation, underwrite its securities, or perform advisory services). See JAMES E. HEARD & HOWARD D. SHERMAN, CONFLICTS OF INTEREST IN THE PROXY VOTING SYSTEM 40 (Investor Responsibility Research Ctr. ed., 1987) (finding that potential conflicts of interests are widespread among institutional fund managers); James A. Brickley, Ronald C. Lease & Clifford W. Smith, Jr., *Ownership Structure and Voting on Anti-takeover Amendments*, 20 J. FIN. ECON. 267, 276-79, 284 (1988); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor As Corporate Monitor*, 91 COLUM. L. REV. 1277, 1321-22 (1991); Rock, *supra* note 33, at 469-72, 480; see also Edward B. Rock, *Controlling the Dark Side of Relational Investing*, 15 CARDOZO L. REV. 987, 989 (1994) (describing instances of "corrupt" relational investing in which large shareholders benefit themselves or protect management to the detriment of other shareholders and noting the "rather toothless legal controls" for stopping such behavior); Mark J. Roe, *Political and Legal Restraints on Ownership and Control of Public Companies*, 27 J. FIN. ECON. 7, 29 (1990) ("Conflicts of interests tilt some institutional investors toward management. Institutions that have something to sell to the managers (a loan, a pension plan) are apt to succumb to managerial control.").

Private pension funds have similar conflicts: they make money by managing corporations' pension funds. Because management selects which pension fund will manage its employees' retirement money, it can take its business away from funds that choose shareholder interests over manager interests. See Rock, *supra* note 33, at 469; Roe, *supra*, at 24-25; Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 796 (1993) (stating that public pension funds face conflict problems similar to those encountered by private pension funds). Potential corruption in the selection of private pension funds could be significantly lessened by giving the beneficiaries the right to elect pension funds. Recommendations for fund managers should come not only from management, but also from large shareholders whose interests are aligned with the interests of the

One promising, recently proposed reform, with which this Article is quite compatible, would grant shareholders the ability to initiate charter amendments dealing with corporate process and structure.³⁶ Just as most states require shareholders to approve but do not allow shareholders to initiate voluntary dissolution,³⁷ most states require shareholders to approve but do not allow shareholders to initiate charter amendments.³⁸ As a consequence, once

workers *qua* shareholders.

Even absent a conflict, fund managers lack meaningful incentives that would align their interest with shareholders. See Rock, *supra* note 33, at 469-78. Black, however, argues that incentives for money managers to monitor effectively are more effective than generally thought. See Black, *supra* note 26, at 876-82. For several years, public pension funds have stood out as effective advocates for shareholder wealth-maximizing behavior. Pro-management reaction against their efforts has begun, however, and political pressures to restrain them grow in proportion to their monitoring effectiveness. See Romano, *supra*, at 796-98. Romano explains how political intervention works to the disadvantage of the principals (shareholders) and to the advantage of agents (politicians, management) without conferring meaningful benefits on the putative beneficiaries of the interference. See *id.*; see also William W. Bratton & Joseph A. McCahery, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 N.C. L. REV. 1861, 1903-25 (1995) (describing the incentive problems that impair institutional shareholders' effective participation in corporate governance); Rock, *supra* note 33, at 471-72, 481 n.132 (noting that public fund managers may be pressured by public interest groups as well as by state and local governments); Roe, *supra*, at 27-29.

Finally, large shareholders are unlikely to trade the ease of exit that they currently enjoy through their liquidity for the thorny problems of management oversight. See Coffee, *supra*, at 1281-89.

³⁶ See Bratton & McCahery, *supra* note 35, at 1872-76.

³⁷ See *supra* note 12.

³⁸ For statutes restricting the power to initiate charter amendments to the board, see ALA. CODE § 10-2B-10.03(b)(1) (1994); ALASKA STAT. § 10.06.504(2) (1989) (providing that, although shareholders can propose charter amendments, the board must present the amendment for a shareholder vote); ARIZ. REV. STAT. ANN. § 10-059(A)(1) (1990), *repealed by* ARIZ. REV. STAT. ANN. § 10-1003 (1995) (effective Jan. 1, 1996); ARK. CODE ANN. § 4-27-1003(B)(1) (Michie 1991); CAL. CORP. CODE § 902(a) (West 1991); COLO. REV. STAT. § 7-110-103(2)(a) (1995); CONN. GEN. STAT. ANN. § 33-360(b) (West 1995), *repealed by* 1994 Conn. Acts 94-186, § 214 (Reg. Sess.) (effective Jan. 1, 1997); DEL. CODE ANN. tit. 8, § 242(b)(1) (1991); FLA. STAT. ANN. § 607.1003(1) (West 1996); GA. CODE ANN. § 14-2-1003(b)(1) (1994); HAW. REV. STAT. § 415.59(1) (1992); IDAHO CODE § 30-1-59(a) (1995); ILL. ANN. STAT. ch. 805, para. 5/10.20(a) (Smith-Hurd 1993); IND. CODE ANN. § 23-1-38-3(b) (Burns 1995); IOWA CODE ANN. § 490.1003(2)(a) (West 1991); KAN. STAT. ANN. § 17-6602(b)(1) (1994); KY. REV. STAT. ANN. § 271B.10-030(2)(a) (Michie/Bobbs-Merrill 1989); ME. REV. STAT. ANN. tit. 13-A, § 805(1)(A) (West 1981); MD. CODE ANN., CORPS. & ASS'NS § 2-604(b)(1) (1993); MISS. CODE ANN. § 79-4-10.03(b)(1) (1989); MO. ANN. STAT. § 351.090(1)(b) (Vernon 1990); MONT. CODE ANN. § 35-1-227(2)(a) (1993); NEB. REV. STAT. § 21-2057(1) (1991); NEV. REV. STAT. § 78.390(1)(a) (1994); N.H. REV. STAT. ANN. § 293-A:10.03(b)(1) (1994); N.J. STAT. ANN. § 14A:9-2(4)(a) (West 1995); N.M. STAT. ANN. § 53-13.2(A) (Michie 1993); N.Y. BUS. CORP. LAW § 803(a) (McKinney

management has obtained a charter amendment, shareholders are powerless, short of a proxy fight or takeover, to override the charter provision. Freeing shareholders to control the charter amendment process would both prevent abuses and guarantee greater management accountability. For present purposes, however, shareholder access to structure and process charter amendments, though improving the power balance between shareholders and management, will not provide shareholders with an autonomous means to displace inefficient managers.

In any event, dissolution will not compete with such reforms but will complement them. The ability of shareholders to force an auction of the company if the board fails to maintain shareholder value would empower shareholders far more than would changes in the regulatory framework. Conversely, dissolution—at least in the absence of a bid—is somewhat risky. Accordingly, shareholders would resort to dissolution only when no practical remedy other than the sale of the company exists.³⁹

Dissolution will also benefit non-shareholder constituencies. Takeovers occur only when managerial ineffectiveness has lowered

1986); N.C. GEN. STAT. § 55-10-03(b)(1) (1990); OKLA. STAT. ANN. tit. 18, § 1077(B)(1) (West 1986); OR. REV. STAT. § 60.437(2) (1993); R.I. GEN. LAWS § 7-1.1-54(a)(1) (1992); S.C. CODE ANN. § 33-10-103(b)(1) (Law. Co-op. 1990); S.D. CODIFIED LAWS ANN. § 47-2-11 (1991); TENN. CODE ANN. § 48-20-103(b)(1) (1995); TEX. BUS. CORP. ACT ANN. art. 4.02(A)(1) (West 1995); UTAH CODE ANN. § 16-10a-1003(2)(a) (1995); VT. STAT. ANN. tit. 11A, § 10.03(b)(1) (1993); VA. CODE ANN. § 13.1-707(B)(1) (Michie 1993); WASH. REV. CODE ANN. § 23B.10.030(2)(a) (West 1994); W. VA. CODE § 31-1-107(a) (1988); WIS. STAT. ANN. § 180.1003(1)(a) (West 1992); WYO. STAT. § 17-16-1003(b)(i) (1989).

States that allow shareholders to initiate charter amendments are decidedly in the minority, but they are by no means inconsiderable. *See* ALA. CODE § 10-2B-14.02(b)(1) (1994); CONN. GEN. STAT. ANN. § 33-330(c) (West 1995) (repealed Jan. 1, 1997); FLA. STAT. ANN. § 607.0702(1)(b) (West 1993); LA. REV. STAT. ANN. § 12:31(B) (West 1994); MASS. GEN. LAWS ANN. ch. 156, § 71 (West 1992); MICH. STAT. ANN. § 21.200(611) (Callaghan 1988); MINN. STAT. ANN. § 302A.135(2) (West 1985); N.D. CENT. CODE § 10-19.1-19(2) (1995); OHIO REV. CODE ANN. § 1701.71(A)(1) (Anderson 1992); 15 PA. CONS. STAT. § 1912(a)(2) (1995).

³⁹ Professor John Coffee has noted how self interest pushes the takeover market to focus where it is most needed. Even if the market undervalues all corporations, bidders will look for undermanaged companies where they can profit from a "double gain," taking advantage of both (a) any systemic market discount and (b) the possibilities for gain from increasing managerial efficiency in previously undermanaged companies. *See* Coffee, *supra* note 1, at 1172-73. Once dissolution has freed arbitrageurs from their reliance on bidders to precipitate auctions, arbitrageurs will have greater incentives to track down and to profit from such "double gains" created by managerial inefficiencies, thereby ameliorating any market inefficiencies that exist.

the company's stock price sufficiently to allow bidders to offer huge premiums. Similarly, outside directors have ejected executive officers only when the loss of shareholder value has damaged the directors' reputations.⁴⁰ Such delayed discipline has necessitated disruptive changes to restore the corporation's health and competitiveness: restructurings, downsizings, layoffs, plant closings, and other actions designed to wring more value from the company's assets. Properly understood, the cause of the disruption is the managerial inefficiency that eroded the corporation's value.

Disciplinary mechanisms—whether takeovers, more activist boards, or dissolution—correct, not cause, these inefficiencies. Because takeovers typically occur only after a significant decline in value, a takeover constitutes a drastic remedy. Dissolution, on the other hand, would intervene more promptly and operate more continuously and more widely than do takeovers, thereby displacing inefficient managers before the need for a radical remedy emerges. Additionally, dissolution would indirectly discipline healthy corporations by serving as a background threat against managerial inefficiency, thus forestalling the need for later restructurings and damage to other constituencies.

II. THE USE OF DISSOLUTION IN CLOSE CORPORATIONS AND IN PUBLIC CORPORATIONS

A. *The Use of Involuntary Judicial Dissolution in Close Corporations*

The benign use of involuntary judicial dissolution is well understood in the close corporation context.⁴¹ Close corporation

⁴⁰ Boards have recently begun displacing ineffective managements in some numbers, but only after long periods of ineffective management. See, e.g., Black, *supra* note 9, at 630-31 (declaring that monitoring of top managers by directors is "notable mostly for its absence" and its sluggishness); Gilson & Kraakman, *supra* note 28, at 995 n.40 (citing the aggressiveness of outside directors of General Motors, American Express, and Westinghouse as examples of boards acting only after long periods of poor performance); Martin Lipton & Jay W. Lorsch, *A Modest Proposal for Improved Corporate Governance*, 48 BUS. LAW. 59, 59 (1992) (stating that "[c]orporate governance in the United States is not working the way it should" because directors are far too slow to act). For discussion of structural limitations inherent in board dynamics that curb the monitoring effectiveness of directors, see Jensen, *Modern Industrial Revolution*, *supra* note 17, at 862-67.

⁴¹ See, e.g., Steven C. Bahls, *Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy*, 15 J. CORP. L. 285, 295-98 (1990) (discussing the development of court-mandated dissolution); Donald F. Clifford, Jr., *Close Corporation*

Shareholder Reasonable Expectations: The Larger Context, 22 WAKE FOREST L. REV. 41, 41 (1987) (acknowledging the utility of judicial dissolution in discussing the doctrine of disappointment of reasonable expectations); Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 283 (1986) (noting that "many states supply automatic rules for involuntary dissolution in closely held . . . corporations"); Rodman Elfin, *Suggested Revisions of the Law Pertaining to the Dissolution of Partnerships and Close Corporations*, 25 AM. BUS. L.J. 93, 110-15 (1987) (noting that the ability to petition the court for involuntary dissolution is critical to minority shareholders of close corporations and urging that statutes give close corporation shareholders the ability to dissolve the corporation unless the charter provides to the contrary); Shelby D. Green, *"Reasonable Expectations" Define Board Power to Liquidate a Solvent Close Corporation in Bankruptcy*, 41 DRAKE L. REV. 421, 424 (1992) (discussing dissolution by the boards of close corporations experiencing financial difficulty and recommending that, absent contrary charter provisions, "the power of the board of directors of a solvent close corporation to file a voluntary petition for liquidation in bankruptcy must be determined by the theory of 'reasonable expectation'"); Harry J. Haynsworth, *The Effectiveness of Involuntary Dissolution Suits As a Remedy for Close Corporation Dissension*, 35 CLEV. ST. L. REV. 25, 26 (1986) (finding that "for the most part judges have done a commendable job of balancing the expectation interests of minority shareholders against inherent voting and management rights of majority shareholders"); John A.C. Hetherington, *Bargaining for Fiduciary Duties: Preserving the Vulnerability of the Disadvantaged?*, 70 WASH. U. L.Q. 341, 344 (1992) (defending the use of involuntary dissolution to protect against majority shareholders oppressing minorities by disputing claims that minority oppression of majority shareholders is a pervasive problem); Jason S. Johnston, *Opting In and Opting Out: Bargaining for Fiduciary Duties in Cooperative Ventures*, 70 WASH. U. L.Q. 291, 301-03 (1992) (finding that allowing minority shareholders in a close corporation the option of dissolution serves as a credible alternative to costly monitoring); Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 440-61 (1990) (stating that while dissolution is not a drastic remedy, it is also not an extremely effective remedy because minority shareholders are impacted disparately and noting that dissolution is incorrectly viewed as "corporate death"); Joseph E. Olson, *A Statutory Elixir for the Oppression Malady*, 36 MERCER L. REV. 627, 628 (1985) (applauding the expansion of rights to minority shareholders in closely held corporations who may otherwise be "locked in"); O'Neill, *supra* note 14, at 653 (advocating legal remedies that encourage owner-managers in owner-managed firms to discuss problems and strike compromises); Robert B. Thompson, *Corporate Dissolution and Shareholders' Reasonable Expectations*, 66 WASH. U. L.Q. 193, 199 (1988) [hereinafter Thompson, *Shareholders' Reasonable Expectations*] (discussing the judicial development of a reasonable expectations standard to determine whether involuntary dissolution should be given as a remedy); Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699, 699 (1993) (noting that courts broadly interpret the legislative grounds for judicial dissolution of a corporation in assessing remedies).

For discussion urging greater protections for non-shareholder claimants against dissolving corporations, whether close or public, see Moira A. Hogan, Comment, *Life After Death: Corporate Dissolution and the Continuing Corporate and Shareholder Liability Doctrine in California*, 33 SANTA CLARA L. REV. 135 (1993) (describing the evolution of remedies available to minority shareholders in close corporations).

Corporate law casebooks reserve extended analysis of dissolution for the close corporation context. Casebooks focus almost exclusively on (judicially ordered) involuntary dissolution. See WILLIAM L. CARY & MELVIN A. EISENBERG, CASES AND

shareholders lack protections available to partners in general partnerships and to shareholders in public corporations. Partners can escape oppression by withdrawing from the partnership, thereby dissolving the partnership and forcing a buyback of their partnership interest. Corporate law has also adapted dissolution to protect close corporation minority shareholders. Currently, where a court finds that insiders have oppressed minority shareholders,⁴² it can order dissolution and mandate payment to shareholders on a proportionate basis. This remedy allows minority shareholders to force insiders either to give them a fair price for their stock or to have the corporation sold or liquidated. By decreeing dissolution, the court removes from insiders the strategic advantages of total control over corporate payouts.

In theory, involuntary judicial dissolution requires the break-up of the corporation, but in practice, its effects are much milder. In a ground-breaking article published in 1977, Professors Hetherington and Dooley showed that court-ordered dissolution of solvent close corporations typically led to the insiders buying out the minority's shares, rather than causing the liquidation of the corporation.⁴³ Hetherington and Dooley showed that involuntary

MATERIALS ON CORPORATIONS 522-24, 527-52 (7th ed. 1995); JESSE H. CHOPER ET AL., CASES AND MATERIALS ON CORPORATIONS 764-84 (3d ed. 1989); MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 1044-55 (1995); ROBERT W. HAMILTON, CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED PARTNERSHIPS 547-63 (5th ed. 1994); HARRY G. HENN, TEACHING MATERIALS ON THE LAWS OF CORPORATIONS WITH COMPARISONS OF GENERAL AND LIMITED PARTNERSHIPS AND OTHER UNINCORPORATED ORGANIZATIONS AND SYNOPSIS OF AGENCY LAW 650-70 (2d ed. 1986); WILLIAM A. KLEIN & J. MARK RAMSEYER, CASES AND MATERIALS ON BUSINESS ASSOCIATIONS 626-52 (2d ed. 1994); LARRY E. RIBSTEIN, BUSINESS ASSOCIATIONS 225-75 (2d ed. 1990); LEWIS D. SOLOMON ET AL., CORPORATIONS: LAW AND POLICY MATERIALS AND PROBLEMS 518-30 (3d ed. 1994).

⁴² In the typical scenario, the corporation pays "executive compensation" that, in a world without taxes, would be dividends to shareholders. Minority shareholders can be damaged if they are terminated as officers: majority shareholders can then make payouts only to those shareholders who are employees, even though originally employee compensation was based on stock ownership. Because the corporation limits dividends to avoid double taxation, minority shareholders have no basis for expecting corporate payouts. See, e.g., *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1180 (N.Y. 1984) (holding that the withholding of all cash payments from minority shareholders constituted "oppressive action" and upholding the grant for dissolution of the corporation).

⁴³ See J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 29-30 (1977) (interpreting the results of a study of 54 cases involving petitions for involuntary dissolution to be consistent with the proposition that "while a decision to grant or deny dissolution will have some effect on whether the parties continue in

dissolution merely changes legal status, shifting the parties' bargaining leverage. Court-ordered dissolution places minority shareholders in a favorable position to negotiate for something approximating the fair value of their shares.⁴⁴ Without a decree of dissolution, minority shareholders are at a serious negotiating disadvantage.⁴⁵

Thus, involuntary dissolution for close corporations guards against minority oppression. It either levels the terrain on which oppressed minority shareholders negotiate or (quite rarely) forces liquidation. In either event, dissolution unlocks from the grip of insiders something approximating the full value of the minority's shares, value which would otherwise remain lost to those shareholders.

B. *The Use of Voluntary Dissolution in Public Corporations*

Although involuntary judicial dissolution is firmly established as a remedy for oppression of close corporation minority shareholders, no one heretofore has shown how voluntary dissolution could allow public corporation shareholders to realize the fair value of their stock.⁴⁶ As described above, in the absence of takeovers, share-

business together, it will have no independent effect on the continued existence of the firm").

Later studies have confirmed their findings. See 2 HAROLD MARSH, JR., MARSH'S CALIFORNIA CORPORATION LAW § 20.22, at 638 (1981 & Supp. 1986) (stating that "a liquidation does not necessarily contemplate that the assets will be sold piecemeal and the goodwill of the business sacrificed by a termination of the business"); Bahls, *supra* note 41, at 297-98 (finding that dissolution does not typically lead to liquidation); Murdock, *supra* note 41, at 441-43 (updating and reiterating the assertion that dissolution does not lead to liquidation and social losses). But see Robert W. Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations*, 67 MINN. L. REV. 1, 69-75 (1982) (noting the costs, as well as the benefits, of dissolving close corporations).

Research on the economics of liquidation shows that even piecemeal liquidation, where the corporation is broken up and sold to several bidders, can enhance shareholder value. See *infra* notes 64-67 and accompanying text.

⁴⁴ See Hetherington, *supra* note 41, at 344 ("There seems to be no chance, however, that [the price resulting from the bargaining following a decree of dissolution] will exceed the plaintiff's pro rata share of the going-concern value of the firm.").

⁴⁵ See *id.* ("[I]n the absence of a decree the majority would normally expect to buy out the minority for less than its pro rata share of the going-concern value (an illiquidity discount) . . .").

⁴⁶ Indeed, voluntary dissolution can redress the public corporation shareholders' problem without disrupting the actual business run by the corporation. Just as a corporate reorganization under Chapter 11 of the Bankruptcy Code merely reorders existing claims against the corporation while leaving the underlying business operat-

holders lack credible disciplinary mechanisms, and management can thus allow shareholder wealth to decline. If dissatisfied shareholders exit, the price they receive is discounted by the expected loss of wealth. Given the enormous size of public corporations, public shareholders likely lose more in absolute dollar amounts than close corporation shareholders.

Dissolution could enable public corporation shareholders to stem such erosion of value. Dissolution would trigger the auction of corporate assets out from under underperforming managers. Shareholders ought to possess the power to compel an auction. Shareholders, after all, *create* the corporation;⁴⁷ they should have the right to terminate its existence whenever they, as a group, wish. Dissolution would not bear on the management of the corporation, which remains in the hands of the board.

Shareholders would likely vote for dissolution only where a bidder has actually offered a significant premium or where market signals⁴⁸ convince them to invite such bidding. Even where dissolution results in a corporate break-up, the break-up value will normally exceed the going-concern value.⁴⁹

ing, so voluntary dissolution could provide for transfer of ownership and management while leaving the underlying business operating as well. Just as corporate reorganizations afford creditors the maximal value of their investment, so too could voluntary dissolutions afford shareholders the maximal value of their investment.

Traditionally, shareholders have been thought to lack the power to call for an accounting comparable to the power that debtholders have to foreclose on the corporation's assets if the firm defaults. At most, shareholders are treated as having only the power to elect a slate of directors who would have the power, but not the legal obligation, to make such an accounting. With dissolution, an absolute majority of shareholders would have the right to a de facto "maturity," as it were, which right they could accelerate when management "defaults" on maximizing shareholder value. As with reorganizations, dissolution would impose substantial costs. Yet it would provide greater benefits in guaranteeing shareholders the ability to liberate themselves from suboptimizing management without themselves having to conduct or wait for a takeover.

⁴⁷ Technically, "shareholders" do not exist until the corporation issues and sells its capital stock; it is the incorporator who creates the corporation. Realistically, however, the shareholders create the corporation. The incorporator is a mere functionary performing a ministerial task at the direction of those who cause the corporation to be formed only because they will become its shareholders. See, e.g., N.Y. BUS. CORP. LAW § 601 (McKinney 1986) (stating that "[a]ny reference in this chapter to a 'by-law adopted by the shareholders' shall include a by-law adopted by the incorporator or incorporators").

⁴⁸ For discussion of which market signals should trigger dissolution, see *infra* notes 51-63 and accompanying text.

⁴⁹ See *infra* notes 64-67 and accompanying text.

Thus, by voting for dissolution, public shareholders would accomplish what a court accomplishes when it decrees involuntary dissolution for a close corporation: the directive to insiders to give shareholders the pro rata value of their shares or else see the corporation liquidated. The board would dispose of either the corporation's assets or its shares or merge the company with another at the highest price reasonably attainable. After providing for the corporation's liabilities, the board would distribute the proceeds of this sale to the shareholders pro rata.

III. HOW DISSOLUTION WILL WORK AS A BUSINESS MATTER

A. *How Stock Market Professionals Will Signal to Shareholders How to Vote*

Where shareholders can force an auction, any large disparity between *S*'s current share price and its potential value at auction (hereafter "disparity") creates significant arbitrage opportunities. There are two primary situations in which shareholders will benefit from using dissolution to force the auction and eliminate the disparity. In the first situation, a bidder has already launched a takeover battle. By triggering dissolution, shareholders circumvent takeover defenses and force a *Revlon*-style auction.⁵⁰ In the second situation, no bidder has yet surfaced, but the magnitude of the disparity implies that if shareholders force an auction, one or more bidders *will* come forward and pay shareholders a significant premium. Voting for dissolution then elicits bidders.

The arbitrage mechanism for identifying profits to be realized via dissolution resembles that used in takeovers generally.⁵¹ Incumbent management's success or failure to maximize *S*'s value is reflected by *S*'s stock price.⁵² If management has maximized the value of *S*'s assets, *S*'s stock price will approximate the highest price any potential new management could reasonably pay for use of those assets, and any disparity will be small. On the other hand, if management has not value-maximized, the disparity will be greater. Where the disparity is sufficiently large, bidders can pay a substantial premium and still profit from acquiring *S*.

⁵⁰ See *supra* notes 6-8.

⁵¹ For a still serviceable account of the market mechanisms that allowed bidders to make arbitrage profits, see Manne, *supra* note 15, at 112-13.

⁵² For discussion of stock price as the most reliable indicator of the corporation's value, see *infra* notes 80-82 and accompanying text.

The dismal history of conglomerates before takeovers undid much of their damage⁵³ demonstrates that managers can allow substantial disparities for considerable periods without redeploying *S*'s assets more productively. Where management fails to eliminate the disparity and is unwilling to sell *S* voluntarily, the takeover market has historically facilitated the transfer of *S*'s assets to more productive uses. Where bidders could operate or dispose of underutilized corporate assets more profitably than incumbent management, they could pay *S*'s shareholders a premium sufficient to induce them to sell their shares.

B. *Why Dissolution Would Do a Better Job Eliciting
Bids Than Hostile Takeovers Have*

Any bidder's willingness to pay a significant premium requires three conditions: (1) credible information that *S*'s assets would be more valuable in other hands, (2) financing for the takeover, and (3) the legal ability to consummate the takeover. During the takeover era, bidders profited by satisfying all of these conditions themselves. Today, however, takeover defenses reduce bidders' incentives to expend the resources necessary to satisfy them. Even when bidders can pay *S*'s shareholders a substantial premium for *S*'s assets, *S*'s management may well frustrate bidders' efforts. Dissolution can remedy this management-created impasse by eliciting market responses that will make bidding profitable. These market responses will, in turn, recreate the conditions required for profitably purchasing undermanaged assets.

1. Condition One: Credible Information That
the Subject Corporation's Assets Would Be
More Valuable in Other Hands

For bidders to bid, the disparity and arbitrage opportunity must be credibly identified and communicated. During the takeover era, bidders looking for disparities did the job of valuing targets largely by themselves, although often assisted by investment banking firms.

⁵³ See, e.g., Black, *supra* note 27, at 903-06 (discussing evidence that corporate diversification reduces company value); F.M. Scherer, *Corporate Takeovers: The Efficiency Arguments*, 2 J. ECON. PERSP. 69, 71 (1988) (noting growing scholarly agreement that conglomerate mergers "led to widespread failure, evidenced in low returns to conglomerate firms' shareholders and extensive divestiture of ill-fitting, poorly-managed subsidiaries").

The bidder "certified" the disparity by actually purchasing *S* stock, thereby exposing itself to loss on its investment.⁵⁴

Dissolution can improve takeover bidders' searching for undermanaged firms by enlisting arbitrageurs, shareholders (especially large shareholders), and bidders jointly in the search. Arbitrageurs and institutional investors⁵⁵ are uniquely suited to uncover disparities and provide other information concerning *S*'s value to potential bidders.⁵⁶ First, the current stock market price provides, for free, an unbiased estimate of the value of *S*'s assets under present management. Second, arbitrageurs make their living by buying stock when corporate assets are underutilized and other managements are willing to pay target shareholders to acquire and redeploy these assets. As *S* approaches the possibility of auction, arbitrageurs' resources will focus on the value of *S* to other managers.

Where shareholder-initiated dissolution is available, if the disparity is large enough and if potential bidders are likely to pay a substantial premium to existing shareholders, both arbitrageurs and existing shareholders will profit from forcing a dissolution. Arbitrageurs can profit by buying *S* stock before the shareholders have voted to dissolve.⁵⁷ Arbitrageurs' buying will then drive up

⁵⁴ Similarly, "greenmail" frequently served the same signaling function, aiding the takeover market. See Jonathan R. Macey & Fred S. McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 YALE L.J. 13, 28-32 (1985) (arguing that greenmail allows those who generate information about the value of the corporation to profit from discovering corporate resources that can be profitably redeployed, even where they have no desire to manage such assets).

⁵⁵ Institutional investors are served by highly sophisticated investment advisors who possess much the same analytical tools and technology as arbitrageurs. Like arbitrageurs, these institutions can earn profits for their beneficiaries using dissolution. Because the focus of the present discussion is on arbitrage as the mechanism for identifying and capturing profits, the text will hereafter refer solely to arbitrageurs. Such references should be understood to include, where appropriate, institutional investors as well.

⁵⁶ Arbitrageurs working within a dissolution regime may spot potential gains more efficiently than takeover bidders per se. All market participants, rather than any one particular bidder, will be appraising any difference between *S*'s current and potential value, thereby washing out idiosyncracies peculiar to single bidders.

For discussion of risk arbitrageurs' institutional competence for triggering auction contests, see Coffee, *supra* note 1, at 1290.

⁵⁷ It is costly for a takeover bidder to ascertain that it could operate *S* more profitably than current management. Indeed, the most convincing theoretical argument for prohibiting management from conducting auctions derives from the large "search costs" incurred by the initial bidder in identifying the best target. By free riding on the search efforts of the initial bidder, later bidders retain greater resources with which to bid against the former. Allowing such free riding reduces incentives

the share price, thus signaling shareholders to approve dissolution. By investing their own money, arbitrageurs bond the quality of their information about an imminent premium. When arbitrageurs predict an auction at a premium, they will bid up the share price to the maximum where their returns from the auction proceeds compensate them for their investment. Because dissolution eliminates target managers' ability to block the auction, arbitrageurs face less risk and can buy more *S* stock at higher prices. When arbitrageurs predict a large premium, they signal a major disparity, thus certifying *S*'s worth to one or more potential bidders.⁵⁸ Where arbitrageurs are correct, they profit handsomely. By contrast, where they cannot cause a substantial price increase, thereby credibly communicating a disparity to bidders, bidders will *pro tanto* have less incentive to offer a premium. If, in the absence of a substantial premium, *S* shareholders then vote against the dissolution, arbitrageurs lose money on their investment. Thus, the inherent riskiness of investing on the prospect that shareholders will dissolve *S* and that bidders will purchase *S* at a premium will make arbitrageurs focus only on those corporations with the greatest disparities.⁵⁹

to identify targets. See EASTERBROOK & FISCHER, *supra* note 1, at 187-90 (stating that auctions injure the initial bidder who spends time and money discovering targets, thereby allowing subsequent bidders to enter the fray at a lower cost).

Dissolution, on the other hand, would encourage players other than bidders to identify the disparity. For example, investment banking firms and other financial institutions that analyze corporations in the ordinary course of their business develop information that would frequently reveal any significant disparity but that, in the absence of a bidder, is typically not a source of substantial trading gains. These market participants could use this information profitably by purchasing shares and, shortly thereafter, disseminating this information and arousing support for dissolution. Thus, the dissolution regime aligns different parties' interests and resources for the benefit of all: (a) those who have information about which they are sufficiently certain to trade can profit from such trades if they are correct; (b) potential bidders who can maximize the value of corporate assets are aided in their search by an army of investment professionals who are compensated only through their own trades and only if their information and judgment are correct; and (c) shareholders who want to sell their shares at a premium can force an auction, if a premium is likely.

⁵⁸ See Arnoud W.A. Boot, *Why Hang On to Losers? Divestitures and Takeovers*, 47 J. FIN. 1401, 1416 (1992) (suggesting that takeover bids signal not only that the target is inefficient but also that the bidder "has identified a high-value user for the target's incompatible asset").

⁵⁹ Coffee has made a similar point concerning the wealth-enhancing effect of hostile takeovers at high premiums. See Coffee, *supra* note 1, at 1232 (arguing that "the more a party is willing to invest in its own judgment, the greater the confidence that society can also place in it"). For discussion of arbitrageurs' risk-return calcula-

To the extent that arbitrageurs, foreseeing profits from a bidding situation, have purchased *S* stock and driven up its price, existing shareholders can infer that "Wall Street" believes that a vote for dissolution will result in a significant premium.⁶⁰ The greater the premium that arbitrageurs expect from any particular situation, the more they will pay for *S* stock, the sharper the rise in its price, the greater the potential profits to existing shareholders on account of the anticipated dissolution,⁶¹ the greater the likelihood that *S*

tions, see David F. Larcker & Thomas Lys, *An Empirical Analysis of the Incentives To Engage in Costly Information Acquisition: The Case of Risk Arbitrage*, 18 J. FIN. ECON. 111, 118-23 (1987).

⁶⁰ Because upward price movement near the time of the dissolution vote will suggest the market's expectation that *S* will be sold at a premium, management may attempt to obscure the price movement's meaning. It could try to offset the rise by manipulating stock prices downward, perhaps by releasing bad news (such as unfavorable future prospects) or by taking actions that will push its stock price down (such as lowering dividends). The nature of the dissolution vote, however, should make such behavior unavailing. If there is sufficient support for dissolution, the share price should become a function of likely prices in an auction, rather than of management's future deployment of corporate assets.

On the other hand, management may announce favorable projections and then claim that the upward price movement is more a function of improving company prospects than of any benefit from approving *S*'s dissolution. Such positive signals might confuse shareholders, but the extent of such confusion is limited by the dictates of the securities laws and, more importantly, by traders and investigative journalists who decode the meaning of such price movements.

Naturally, certain investment banking firms will find it lucrative consistently to echo management's views. If they consistently favor management, however, they will have difficulty maintaining their credibility. Where dissolution is rejected, one of two things will happen. If improved company fortunes truly caused the share price increase, the stock price should remain at the same level after shareholders reject dissolution. If, on the other hand, the share price rose due to the expectation of gains from an auction, the stock price should fall to its level before the upcoming dissolution vote could have any price effect. (I assume a regime in which shareholders are restricted to only one dissolution vote per year. See, e.g., *infra* note 124 and accompanying text (citing a New York statute limiting dissolutions to one per year).) Sources correctly interpreting the data will thus correctly predict the post-vote stock behavior, while biased sources will discredit themselves.

In this respect, the lapse of time before the next dissolution vote may provide clearer market reactions than takeover bids. The defeat of any one takeover bid will not necessarily forestall another bid, and share prices could remain elevated in hopes of another bid materializing shortly. See Michael Bradley, Anand Desai, & E. Han Kim, *The Rationale Behind Interfirm Tender Offers: Information or Synergy?*, 11 J. FIN. ECON. 183, 189-98 (1983) (finding that abnormal returns for target corporation stock remained present for those firms that were later taken over but dissipated for those firms whose subsequent bids did not materialize). Speculators hoping for dissolution because they view the subject corporation as underperforming will likely hold their stock only if they anticipate another dissolution vote soon. Thus, where shareholders can call dissolution votes only once in any 12-month period, most of the dissolution-premium in the share price should vanish if dissolution fails.

⁶¹ Similar market reactions are observed when managers announce their plan

shareholders will vote to trigger *S*'s auction, and the greater the attention potential bidders should pay to *S* as an acquisition target.⁶² Conversely, if *S*'s stock price does not rise, market professionals are signaling that they do not anticipate a premium from auctioning the company,⁶³ and existing shareholders will know to vote against dissolution.

Empirical evidence indicates that voluntary dissolution can significantly increase shareholders' wealth but that managers initiate dissolution only when doing so serves their own interests. A 1993 study by Gayle Erwin of all sixty-one voluntary liquidations between 1973 and 1991⁶⁴ found significant market price gains associated with announcements of the liquidations.⁶⁵ Other studies have also

voluntarily to liquidate their corporations; the greater the disparity, the higher the rise in share price at the announcement. See Gayle R. Erwin, *Live or Let Die? An Analysis of the Decision to Voluntarily Liquidate the Firm* 151 (1993) (unpublished Ph.D. dissertation, Purdue University) ("[W]hen the break-up value of the firm is higher than its value as a going concern, the market . . . view[s] the news of the impending sale more favorably the more underutilized the assets . . .").

⁶² Note that bidders should not be deterred if *S*'s market price increases, even before the bidder makes a tender offer, to a price near the bidder's eventual price. Shareholders want a premium over the share price of the company *under incumbent management* (i.e., before the stock price moves due to prospects of dissolution). They should be indifferent as to whether the price rises due to a bidder's actual offer or due to the expectation of an offer that materializes after the price rises. Financial analysts and the financial press can be counted on to explain the dynamics of the price rise to less sophisticated shareholders.

⁶³ For examples in the takeover context of courts properly attending to stock market reaction to events, see *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 799 (Del. Ch.) (noting that, where shareholders were faced with the possibility of either \$74 per share in cash or a management-structured package putatively worth \$76 per share, the fact that market participants valued the stock at approximately \$70 per share indicated their doubts that the management's recapitalization was worth more than the bidder's \$74 per share), *appeal dismissed*, 556 A.2d 1070 (Del. 1988). Applied to the present proposal, such a market signal would caution shareholders to vote against the recapitalization (and for dissolution) if they could. See *Grand Metro. Pub. Ltd. v. Pillsbury Co.*, 558 A.2d 1049, 1057 (Del. Ch. 1988) (stating that the stock market reaction indicated that the bidder's offering price was fair and adequate).

The Delaware Supreme Court mischaracterized the chancery court's analysis as "substituting its judgment as to what is a 'better' deal for that of a corporation's board of directors." *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140, 1153 (Del. 1989). In fact, the chancery court was correctly using the market's reaction to ascertain, as dictated by *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), whether the risk to shareholders of their making an incorrect choice was proportional to denying them the right to choose. See *supra* note 21. By using dissolution, shareholders would not be dependent on the court to retain their right to cash out their investment at full value.

⁶⁴ See Erwin, *supra* note 61, at 138-39, 143-44. Erwin eliminated mergers or sales to one bidder, thereby selecting only management-initiated piecemeal liquidations in which the firm's assets were sold to at least two buyers. See *id.*

⁶⁵ As had an earlier study, Erwin distinguished between firms that had been

found that shareholders reap large positive abnormal returns from voluntary liquidations.⁶⁶ In addition, senior securityholders seem

subject to a bid for control by an outside, would-be acquiror (called the "control bid group" in the earlier study) and those that had not (the "no control bid group"). For the earlier study, see Gailen L. Hite, James E. Owers & Ronald C. Rogers, *The Market for Interfirm Asset Sales: Partial Sell-offs and Total Liquidations*, 18 J. FIN. ECON. 229, 248 (1987) (defining "control bids" as including merger proposals, tender offers, contests for representation on the board of directors, and leveraged buyout proposals). Erwin distinguished between firms that had been approached by friendly or hostile bidders and those that had not been approached by either. See Erwin, *supra* note 61, at 148-49.

The average increase in share price was higher for the no control bid group: 28.35% ($z = 1.22$) from the first liquidation press announcement to shareholder confirmation of the plan and 64.91% ($z = 0.81$) for the total holding period from the "pre-press date" through shareholder confirmation. See *id.* at 150. The pre-press date was computed as "beginning with the year preceding any announcements of financial distress, divestitures, or control contests." *Id.* at 149.

Erwin hypothesized that the control bid group had already seen significant price appreciation due to the earlier acquisition overture(s) and would not show as high a share price increase associated with the liquidation announcement. Her results for the control bid group confirmed their lower returns for the period measured: 14.89% ($z = 2.23$) from the first liquidation press announcement to shareholder confirmation of the plan and 29.42% ($z = 1.77$) for the total holding period. See *id.* at 150.

⁶⁶ In a study of 49 firms that conducted piecemeal liquidations between 1963 and 1983, Hite, Owers, and Rogers found overall average abnormal gains of 25.67% ($z = 2.88$) for the two years preceding the announcement month, and average announcement-period gains of more than 12% associated with the liquidation announcements themselves. See Hite et al., *supra* note 65, at 230, 247. Distinguishing between the control bid group and the no control bid group, they found that the stock of the control bid group had experienced its major price rise prior to the liquidation month, while the major revaluation of the no control bid group occurred during the liquidation announcement month, with "abnormal returns for the two subsamples differ[ing] only in their timing, not in their approximate magnitudes." *Id.* at 248.

Similarly, three other 1987 studies found large positive abnormal returns associated with announcements of voluntary liquidations. Skantz and Marchesini found announcement-month positive average excess returns of 21.4% and average one-year gains of 41%. See Terrance R. Skantz & Roberto Marchesini, *The Effect of Voluntary Corporate Liquidation on Shareholder Wealth*, 10 J. FIN. RES. 65, 65, 68 (1987).

Kim and Schatzberg found gains averaging 30%. See E. Han Kim & John D. Schatzberg, *Voluntary Corporate Liquidations*, 19 J. FIN. ECON. 311, 327 (1987).

Kudla found significant increases in the market value of common stock associated with the liquidation announcement. See Ronald J. Kudla, *Corporate Insiders and the Liquidation Decision* (1987) (unpublished manuscript, University of Wisconsin-Eau Claire), summarized in RONALD J. KUDLA, VOLUNTARY CORPORATE LIQUIDATIONS 35-36 (1988).

Positive gains were also found to be associated with announcements of partial sell-offs. (Sell-offs dispose of one or more parts, rather than all, of a corporation's assets.) See Scott C. Linn & Michael S. Rozeff, *The Corporate Sell-off*, MIDLAND CORP. FIN. J., Summer 1984, at 17, 22 (finding that voluntary sell-offs create value for

to gain as well.⁶⁷

Managers seem to initiate voluntary dissolution, however, only when they (i) face the corporation's declining fortunes *and* (ii) own a high percentage of stock.⁶⁸ Given that managers seem virtually

divesting corporations' shareholders). Linn and Rozeff also list five other studies finding statistically significant positive average abnormal gains of one to two percent associated with announcements of sell-offs. *See id.* at 22-23. Linn and Rozeff present arguments against the standard management explanations for the increase in share price upon announcement of sell-offs, finding the most plausible explanation to be "that the divested assets are worth more to someone else than to the current owner, and that competition among firms for those assets allows the selling firm to obtain 'economic rents' from the sale." *Id.* at 25.

⁶⁷ Where dissolved corporations are liquidated piecemeal, creditors obtain a midstream acceleration of the maturity of their claims. *See, e.g.,* William W. Bratton, Jr., *The Interpretation of Contracts Governing Corporate Debt Relationships*, 5 CARDOZO L. REV. 371, 399 (1984) ("Ultimately, dissolution matures all indebtedness by operation of state law."). Whether voluntary creditors benefit or suffer from being paid early depends on whether, at the time of liquidation, their investment trades at a discount or premium. If, before the liquidation, the debt has undergone a midstream increase in risk (or in the riskless rate) and therefore trades at a discount, the dissolution-triggered prepayment will benefit creditors by eliminating the discount. Conversely, if creditors' claims trade at a premium, dissolution will reduce creditors' wealth by eliminating that premium.

The historical experience of management-initiated voluntary dissolutions suggests that creditors will most often benefit from dissolution-triggered prepayment. Several studies have indicated that values of debt obligations increase upon the announcement of a voluntarily undertaken piecemeal-liquidation. *See, e.g.,* Hite et al., *supra* note 65, at 249 (finding that debt and preferred stock issues experienced two-day returns of 8.57% [without adjustment for normal market returns], and noting that this return provides "at least casual support for the notion that senior claimholders share in the valuation increases associated with liquidation"); Kim & Schatzberg, *supra* note 66, at 326 ("[O]n average bondholders have benefitted from the debt-retirement provision."); *see also* Erwin, *supra* note 61, at 110-11. Erwin hypothesized that the benefits to senior securityholders derive from eliminating discounts due to liquidating companies' previous financial difficulties. *See id.*

⁶⁸ For example, one study found that factors which led managers to liquidate their corporations included "unsolicited takeover attempts, large insider ownership of common stocks, slow growth, large cash reserves, and deterioration in key financial variables." Chinmoy Ghosh, James E. Owers & Ronald C. Rogers, *The Financial Characteristics Associated with Voluntary Liquidations*, 18 J. BUS. FIN. & ACCT. 773, 774 (1991). The authors postulated that the firms' poor performance might have attracted unsolicited suitors (and, in the long run, threatened bankruptcy) and that managers, owning a large percentage of the stock, may have found voluntary liquidation appealing as a way both to avoid possible bankruptcy and to frustrate hostile suitors. *See id.* at 785-86. Ghosh, Owers, and Rogers reported average inside ownership of 24.09%. *See id.* at 780; *see also* Erwin, *supra* note 61, at 87. In her 1993 study, Erwin also found that liquidation was associated with significantly underutilized assets, frequent financial distress, and attempts by outside suitors to acquire control. Erwin found that, compared with industry peers, voluntarily liquidating firms are "characterized by significantly underutilized assets prior to the liquidation decision, as proxied by Tobin's q." *Id.* at 6. In Erwin's view, the most critical factor in insiders'

never to initiate dissolution except when they stand to gain more as shareholders than they will lose as officers, shareholders of large corporations in which managers do not have large shareholdings will need to initiate the dissolution themselves.

Market professionals have already demonstrated their skill in anticipating the prices at which corporate assets will sell in voluntary dissolutions. Erwin found that the share price rose promptly following the liquidation announcement to incorporate the present value of the expected increase in future cash flows from liquidation.⁶⁹ Similar market efficiency has been reported in connection

decision to liquidate was the combination of insiders controlling the board and owning large shareholdings. Erwin's study found average insider shareholdings in the year preceding the liquidation to be 33.2% (median = 29.0%). See *id.* at 87. Erwin hypothesized that the combination of large shareholdings and board control guaranteed that they would realize maximum value for their stock. See *id.* at 119-20.

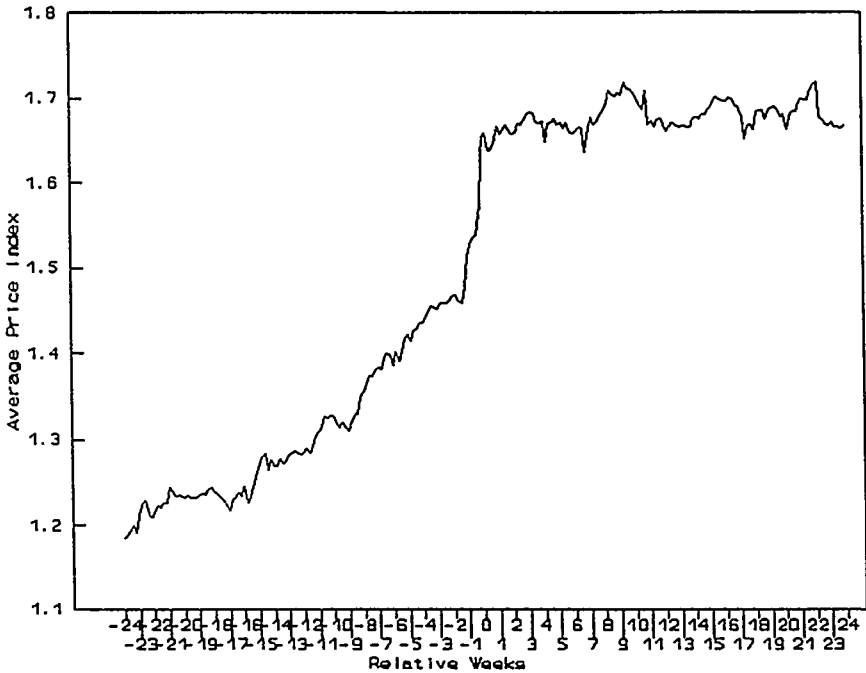
A study by Ronald Kudla probed the agency cost question by investigating whether the likelihood of voluntary dissolution increased in proportion to the insiders' percentage ownership of stock. Based on the evidence, Kudla inferred that larger equity holdings by insiders were positively associated with the wealth increase from liquidation. See KUDLA, *supra* note 66, at 39.

Management's proportional stockholdings have also been shown to correlate positively with tender offers' successes. See James F. Cotter & Marc Zenner, *How Managerial Wealth Affects the Tender Offer Process*, 35 J. FIN. ECON. 63, 67 (1994) (reporting that the probability of a successful tender offer is positively related to changes that the takeover will produce in the managers' wealth: specifically, profits managers reap having their shares purchased by the bidder). Kudla noted that, on average, the insiders owned enough stock so that their salaries constituted only 3.5% of the value of their stock, thereby making the tradeoff between losing their jobs and receiving consideration for their stock less disagreeable. See KUDLA, *supra* note 66, at 41 n.8.

⁶⁹ See Erwin, *supra* note 61, at 154. Erwin noted that "market participants correctly estimated the piecemeal value of the firm's assets using a risk-adjusted valuation model." *Id.* at 158. The average per share price following announcement of the liquidation was \$22.71; the average liquidating payouts, when discounted to present value as of the announcement date using the firm's required rate of return, was \$23.13. See *id.* at 156-57.

Furthermore, after quickly impounding the gain from the impending liquidation, the market's revaluation of the liquidating firm remained stable well after the announcement. See *id.* at 154-55; see also *infra* Figure 1. Figure 1 illustrates that "within the first week following the liquidation announcement, the market has fully incorporated the expected value of the liquidation and that revaluation appears to remain relatively constant thereafter. (Notice the upward drift prior to the liquidation announcement as the market partially anticipates the increase in value, yet there is no upward or downward drift in prices following the liquidation announcements.)". Correspondence from Gail R. Erwin, Assistant Professor of Commerce, McIntire School of Commerce, University of Virginia, to author (Nov. 24, 1995) (on file with author). Professor Erwin statistically tested the efficiency of the market by examining the cumulative abnormal returns and by discounting back the actual liquidating dividends and comparing them to the price immediately following the

FIGURE 1 Comparative Weekly Stock Price Behavior During the Six Months Before and After the Announcement of Voluntary Corporate Liquidation⁷⁰



liquidation announcement. Her results indicate that “the increase in share value at the time of the announcement is equivalent to the actual discounted cash flows from the liquidation process.” *Id.*

⁷⁰ With weekly stock prices being normalized by the stock price six months prior to the liquidation announcement.

with voluntary corporate sell-offs⁷¹ and spin-offs.⁷² Indeed, the market demonstrates impressive efficiency by correctly anticipating the sale of particular assets *before their actual acquisition*.⁷³

Studies have also confirmed risk arbitrageurs' ability to predict accurately the success or failure of tender offers.⁷⁴ Historically, the more confident that arbitrageurs were of the success of the bid, the higher they would bid the target's share price above the pre-announcement level.⁷⁵ The relative degree of such arbitrageur-influenced price increases, in turn, accurately predicted tender offer results.⁷⁶ One study found that arbitrageurs were able to predict

⁷¹ See, e.g., Douglas Hearth & Janis K. Zaima, *Voluntary Corporate Divestitures and Value*, FIN. MGMT., Spring 1984, at 10, 14 (finding significant positive price movements through the announcement date, but no significant price movements after the announcement date); Janis K. Zaima & Douglas Hearth, *The Wealth Effects of Voluntary Selloffs: Implications for Divesting and Acquiring Firms*, 8 J. FIN. RES. 227, 233 (1985) (reporting that generally, "the market reaction to a selloff announcement occurs close to the announcement date and the new equilibrium price is reached quickly").

⁷² See, e.g., James A. Miles & James D. Rosenfeld, *The Effect of Voluntary Spin-off Announcements on Shareholder Wealth*, 38 J. FIN. 1597, 1605 (1983) (finding that average adjusted returns are abnormally positive before and especially on the announcement day but are random after the announcement day, suggesting semi-strong market efficiency valuing the transaction).

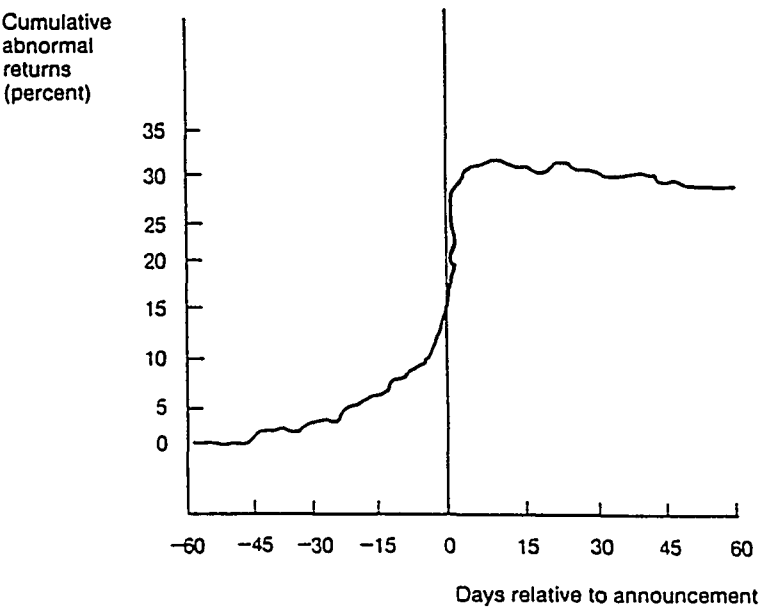
⁷³ Mitchell and Lehn found that, at the time managers announce they are making an acquisition, the market, by revaluing the bidder's stock, is "able to immediately provide an unbiased forecast of the likelihood that the assets will ultimately be divested, long before any cash flows from the resulting business combination are known." Mark L. Mitchell & Kenneth Lehn, *Do Bad Bidders Become Good Targets?*, 98 J. POL. ECON. 372, 388 (1990).

⁷⁴ See, e.g., Larcker & Lys, *supra* note 59, at 111-12, 117 (finding that arbitrageurs were highly successful in predicting which firms would be acquired: firms whose stock was purchased between December 1977 and December 1983 by one or more risk arbitrageurs in amounts sufficient to require filing a Schedule 13D stating a purpose of "arbitrage" or "to participate in a tender offer or merger" had a success rate of 97.12% for being acquired or reorganized); JAMES H. LORIE, PETER DODD & MARY H. KIMPTON, *THE STOCK MARKET: THEORIES & EVIDENCE* 70-73 Fig. 4-9 (reproduced *infra* as Figure 2) (2d ed. 1985) (discussing how corporate takeovers and acquisitions "best illustrate both the speed and unbiased nature of the efficient capital market").

⁷⁵ See William Samuelson & Leonard Rosenthal, *Price Movements As Indicators of Tender Offer Success*, 41 J. FIN. 481, 497-98 (1986).

⁷⁶ See Keith C. Brown & Michael V. Raymond, *Risk Arbitrage and the Prediction of Successful Corporate Takeovers*, FIN. MGMT., Autumn 1986, at 54, 55 (arguing that an ongoing prediction as to the eventual success of the merger can be inferred from the prices set in the post-announcement period); Samuelson & Rosenthal, *supra* note 75, at 497 (arguing that the higher the arbitrageur-influenced price increases, the greater the chance of tender success); see also William P. Dukes, Cheryl J. Frohlich & Christopher K. Ma, *Risk Arbitrage in Tender Offers*, J. PORTFOLIO MGMT., Summer 1992, at 47, 47 (1992) (investigating the profit potential of risk arbitrage in tender offers).

FIGURE 2 Abnormal Returns to Stockholders of Target Firms in Tender Offers



whether mergers would fail or succeed as far as three months in advance of the respective events.⁷⁷ Further, even when initial bids failed, the market correctly anticipated later, successful takeovers.⁷⁸ With few exceptions, arbitrageur-induced market prices measured the expected (discounted) stock price of the target at the conclusion of the contest, with their predictions improving as the conclusion neared.⁷⁹

Market professionals' ability to predict both the break-up values of liquidating corporations and the success rate of hostile takeovers suggests that they will effectively aid economically efficient dissolution. In search of profits, they will ferret out disparities in the stock of companies ripe for dissolution and bid the stock up, thus calling for auction of the corporation and asset redeployment.

One might object that stock prices rise for diverse reasons and that a sudden rise in *S* stock by itself conveys no reliable information. For example, the rise might result from improvements made by incumbent management. Yet arbitrageurs have good incentives to distinguish between news that favors dissolution and news that discourages dissolution. Because arbitrageurs profit only if shareholders dissolve *S* and auction it at a premium, arbitrageurs will investigate which factors have influenced the stock price before making their purchases. Once they have purchased, they will communicate their knowledge to the financial community. Furthermore, since only shareholders can dissolve the corporation and only bidders pay premiums, arbitrageurs will profit from persuading large shareholders to support dissolution and bidders to buy *S* at a premium. Thus, arbitrageurs will likely share with existing shareholders, other market participants, and potential bidders the information about the disparity and the reasons that favor a premium bid.

Managers will likely object that the stock market alone cannot effectively allocate corporate assets. Yet, although criticisms of the efficient markets hypothesis have diminished earlier optimism about

⁷⁷ See Brown & Raymond, *supra* note 76, at 55.

⁷⁸ See Bradley et al., *supra* note 60, at 205 (arguing that the positive revaluation of the shares of targets of unsuccessful tender offers is evidence that the capital market anticipates a future, successful acquisition bid).

⁷⁹ See Samuelson & Rosenthal, *supra* note 75, at 497-98 (finding that "[w]ith few exceptions, market prices are well-calibrated, i.e., the current target price during the offer period measures the expected (discounted) stock price at the conclusion date" and that opportunities for earning excess returns based on non-market "optimal investment polic[ies]" occur infrequently).

the market's absolute efficiency,⁸⁰ the market can play an effective role in the dissolution process. For the market to provide reliable signals for purposes of dissolution, it need only supply more accurate data than does management. In practice, the market is likely to provide more accurate information than would inferior management threatened with the prospect of dissolution.

First, even though, on average, insiders are able to earn abnormal returns trading in their corporations' securities,⁸¹

⁸⁰ For useful recent overviews of the initial acceptance of and ensuing challenges to the market efficiency and market rationality hypotheses, see Eugene F. Fama, *Efficient Capital Markets: II*, 46 J. FIN. 1575 (1991); Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761 (1985); Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851 (1992); Stephen F. LeRoy, *Efficient Capital Markets and Martingales*, 27 J. ECON. LITERATURE 1583 (1989); Robert C. Merton, *On the Current State of the Stock Market Rationality Hypothesis*, in *MACROECONOMICS AND FINANCE: ESSAYS IN HONOR OF FRANCO MODIGLIANI* 93 (Rudiger Dornbusch et al. eds., 1987); William K.S. Wang, *Some Arguments That the Stock Market Is Not Efficient*, 19 U.C. DAVIS L. REV. 341 (1986).

For relevant commentary on market efficiency in the context of hostile takeovers, see Reinier H. Kraakman, *Taking Discounts Seriously: The Implications of "Discounted" Share Prices As an Acquisition Motive*, 88 COLUM. L. REV. 891 (1988); Romano, *supra* note 17, at 143-45, 152; Alan Schwartz, *The Fairness of Tender Offer Prices in Utilitarian Theory*, 17 J. LEGAL STUD. 165, 190 n.43 (1988); J. Gregory Sidak & Susan E. Woodward, *Takeover Premiums, Appraisal Rights and the Price Elasticity of a Firm's Publicly Traded Stock*, 25 GA. L. REV. 783 (1991); Lynn A. Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law*, 99 YALE L.J. 1235 (1990).

For the most informative theoretical treatment of processes by which market participants drive markets toward efficiency, see Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984). For the most informative, brief account of practical mechanisms, see Chris Welles, *Inside the Arbitrage Game*, INSTITUTIONAL INVESTOR, Aug. 1981, at 41. See also Marilyn Much, *Arbitraders: Wall Street's Mystery Men*, INDUSTRY WK., Oct. 1, 1979, at 69 (describing the role of arbitrageurs in the market).

⁸¹ See, e.g., H. Nejat Seyhun, *Do Bidder Managers Knowingly Pay Too Much for Target Firms?*, 63 J. BUS. 439, 441 (1990) [hereinafter Seyhun, *Knowingly Pay?*] ("[I]nsiders earn an average of 3% abnormal return on their transactions."); H. Nejat Seyhun, *Insiders' Profits, Costs of Trading, and Market Efficiency*, 16 J. FIN. ECON. 189, 189 (1986) (stating that studies show that insiders' abnormal profits "vary from 3% to 30% during holding periods of eight months to three years").

Skeptics of the market's relative superiority over management are correct in believing that management possesses an enormous amount of information about the company's innovations, productive capacities, pricing policies, etc. that other market participants lack. The market, on the other hand, may know more about the state of things *outside* the corporation: for example, the state of the economy, consumer tastes, or competitors' products that may render the company's products obsolete. (There is, however, debate over whether *aggregate* insider trades can anticipate future macroeconomic performance. See, e.g., Mustafa Chowdhury, John S. Howe & Ji-Chai Lin, *The Relation Between Aggregate Insider Transactions and Stock Market Returns*, 28 J.

evidence suggests that poor-performing managements (as reflected by their vulnerability to hostile takeover bids) *underperform* the market.⁸² The tendency for less efficient managers to lose money relative to the market, even when they possess the same type of "soft inside information" that better managers use to beat the market, strongly suggests that the market is superior to weaker managements in valuing corporations. Second, underperforming management has compelling incentives to exaggerate its company's value. To keep their jobs, managers will argue that the market "undervalues" S and that dissolution will waste corporate value, even

FIN. & QUANTITATIVE ANALYSIS 431, 437 (1993) (finding that stock market returns appear to cause insider transactions rather than the reverse and that the predictive content of aggregate insider transactions for subsequent market returns appears slight); H. Nejat Seyhun, *Why Does Aggregate Insider Trading Predict Future Stock Returns?*, 107 Q.J. ECON. 1303, 1320 (1992) (finding that aggregate insider trading, although negatively correlated with contemporaneous stock returns, is positively correlated with future stock returns up to 20 months after the trades).)

Also, outsiders may learn through leaks about internal problems of which corporate management is not aware. Thus, much of market professionals' information is proprietary and just as inaccessible to management as management's inside information is inaccessible to market professionals.

⁸² Ekkehart Boehmer and Jeffry Netter studied trades by insiders in their own companies' stock from the period one year before their companies made significant acquisitions until, in the case of managers of companies that became targets of hostile bids, the time of the hostile bid, which came on average approximately two years after the first acquisition. They found that inside stock purchases by managers of firms that were later subject to hostile bids were less successful in terms of the stock's post-trade performance (and more optimistic about the value of their firm) than those of managers of firms that were not later targets of hostile bids. See Ekkehart Boehmer & Jeffry M. Netter, *Management Optimism and Corporate Acquisitions: Evidence from Insider Trading 2* (Mar. 1994) (unpublished working paper, University of Georgia). In the 100 days surrounding their trades, efficient managers earned positive abnormal returns averaging 6.17% ($t = 3.79$), while inefficient managers earned average abnormal returns of -2.23% ($t = -1.65$). See *id.* tbl. 4.

Similarly, H. Nejat Seyhun found that managers of bidder corporations increase their purchases of their own firms' stock before acquiring target firms, even when the acquisitions reduced their own firms' market value by over 5%. See Seyhun, *Knowingly Pay?*, *supra* note 81, at 451 tbl. 5.

This distinction between managers should not be surprising, since better-performing managers should typically make more accurate valuations. For example, superior managements make productive acquisitions; inferior managements make unproductive acquisitions. See Larry H.P. Lang, René M. Stulz & Ralph A. Walkling, *Managerial Performance, Tobin's Q, and the Gains from Successful Tender Offers*, 24 J. FIN. ECON. 137, 139 (1989) (noting that "one would expect poorly performing firms to make poor investments," while well-managed firms would avoid those investments and pay out dividends instead); Randall Morck, Andrei Shleifer & Robert W. Vishny, *Do Managerial Objectives Drive Bad Acquisitions?*, 45 J. FIN. 31, 33-34, 45 (1990) (showing through statistical studies that "bad managers are bad acquirers" and that "firms with better managers are also better acquirers").

if the managers know such assertions lack merit. Consequently, given that market prices apparently outperform weaker managers and that the self-interest of inefficient managers encourages them to overvalue *S*'s worth, the market may be a better indicator as to whether shareholders should dissolve a corporation.

2. Condition Two: Financing

In order to successfully consummate a takeover, bidders must secure adequate financing. In theory, bidders can use corporate securities rather than cash. Historically, however, in hostile bids management typically points to the uncertain value of the bidders' securities and characterizes these securities as inadequate and coercive consideration, thereby justifying management's rejection of the bid. Courts typically accept this argument and allow management to use takeover defenses unless the bidder has offered all cash for all shares.⁸³ To raise cash for the full purchase price, bidders frequently need to borrow. Lenders, in turn, need to feel confident that lending to the bidder will yield a profit.

Target management typically attempts to disrupt bidders' financing by forcing bidders to incur large lender commitment fees before the bidder could assess whether it could successfully acquire the target. Although, historically, the junk bond market solved the financing problem, the demise of Drexel Burnham Lambert and the subsequent diminution of the junk bond market have increased the difficulty of financing hostile takeovers.

Dissolution eliminates several of the primary financing problems encountered in takeovers. First, dissolution pressures arbitrageurs to assess the availability of financing because, practically speaking, arbitrageurs investing in *S*'s stock economically "bond" bidders' potential for financing: if they are wrong, they lose money.

⁸³ See, e.g., *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 956 (Del. 1985) (noting that the use of "junk bonds" in the second-step, squeeze-out merger constitutes "a classic coercive measure designed to stampede shareholders into tendering at the first tier"); *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 796-97 (Del. Ch.) (describing how the structure of an offer can make the tender offer coercive; noting that bidder's all-shares, all-cash offer "is in no respect coercive"), *appeal dismissed*, 556 A.2d 1070 (Del. 1988); *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co.*, 558 A.2d 1049, 1052, 1056, 1058-59 (Del. Ch. 1988) (describing how the form of payment could make tender offers coercive, and noting that bidder's consideration was all cash and that inadequacy of price, not coerciveness, was the only issue concerning the validity of the target's takeover defense).

Second, dissolution allows bidders to use their own securities as consideration. Because voluntary dissolution triggers a mandatory sale of S—a “friendly” transaction by definition—dissolution eliminates the possibility of management resistance. Once directors must auction S, they have nothing to gain from disparaging the bidder’s securities as inadequate and coercive. Rather, as auctioneers, they can use the bidders’ expanded financing options to the advantage of S’s shareholders. S’s board can, for example, condition its recommendation of one bidder’s securities over another’s on a guarantee of the value of the bidder’s securities.⁸⁴ Knowing that their board and the board’s investment bankers have priced the bidder’s securities to reflect accurately their risk and return, S shareholders can accept such securities with confidence. Able to pay in securities as well as in cash, bidders can offer higher prices.

Finally, dissolution eliminates unnecessary financing costs intentionally created by target management to disrupt bidders’ financing and otherwise to saddle bidders with onerous transaction costs.⁸⁵ Dissolution allows bidders to wait for shareholders to vote

⁸⁴ For examples of such guarantees, see Beth McGoldrick, *Treasury Management: Contingent-Value Rights: Are They Debt or Put Options?*, INSTITUTIONAL INVESTOR, May 1990, at 161 (explaining contingent-value rights created in Dow’s acquisition of Marion Laboratories); Alison L. Cowan, *Rival Bidder Diller Says: ‘It’s History’*, N.Y. TIMES, Feb. 16, 1994, at D5 (describing Viacom’s “contingent value right” given to Paramount shareholders as partial acquisition consideration, entitling rightholders to up to \$12 of any difference between \$48 per share and Viacom’s actual share price one year after closing the transaction); Glenn Ruffenach & Randall Smith, *RJR Nabisco Gets Major Jolt in Debt Ratings*, WALL ST. J., Jan. 29, 1990, at A3 (describing reset provisions on RJR Nabisco’s bonds obligating RJR to reset interest rate so that the bonds trade at 100% of face value on a specific date months after the acquisition of RJR by KKR).

⁸⁵ One relatively common ploy is for S’s board to refuse to negotiate with the bidder or consider removing takeover defenses without evidence of “firm” financing. See, e.g., *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34, 39 (Del. 1994) (noting that under its No-Shop provision, Paramount was not allowed to discuss the offer unless the disfavored bidder made an offer “which is not subject to any material contingencies relating to financing”); *Smith v. Van Gorkom*, 488 A.2d 858, 884-85 (Del. 1985) (describing the target CEO’s discrimination against the disfavored bidder on the grounds that the disfavored bidder’s financing was not firm, despite having accepted the favored bidder’s offer when its financing was not firm); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986) (describing a target board unanimously accepting bid of favored bidder over disfavored bidder with equally credible financing on the grounds, in part, that the favored bidder’s “financing was firmly in place”); *CRTF Corp. v. Federated Dep’t Stores, Inc.*, 683 F. Supp. 422, 429-32 (S.D.N.Y. 1988) (discussing at length the reciprocal relationship between financing and the credibility of a takeover bid).

While appearing harmless, this defense can impose substantial costs on the bidder, since the bidder would typically only be able to demonstrate such firm

to dissolve (thereby forcing the auction) before making irrevocable their own obligations to lenders.

3. Condition Three: The Legal Ability to Consummate the Acquisition

Assuming sound financing and willing S shareholders, each bidder has to be assured that takeover defenses will not thwart its bid. Irrespective of shareholder wishes, though, management currently can threaten bidders' success. By the late 1980s, various circumstances united to turn the tide in favor of management and against hostile bids.⁸⁶ Bidders' confidence that they could acquire targets lessened, and hostile takeover bids declined.⁸⁷ Today, absent a replacement for takeovers, management can usually preclude bidders from acquiring the corporation. Where shareholders can force an auction by voting for dissolution, however, they will eliminate the risk that takeover defenses will block desired bids.

Bidders can, of course, play games with shareholders. They can, for example, make a bid, let shareholders dissolve the corporation and then reduce their price. It is, however, in market participants'

financing by triggering its own obligation to pay substantial commitment and other fees to its creditors. *See, e.g.*, LEO HERZEL & RICHARD W. SHEPRO, *BIDDERS AND TARGETS: MERGERS AND ACQUISITIONS IN THE U.S.* 483 (1990) (noting that it has been "customary for a bank to charge a substantial fee for providing a commitment letter . . . in addition to the fees and interest covering the loan itself"). In the normal takeover battle, management has very little doubt of the bidder's financing.

⁸⁶ Takeover defenses were strengthened in the 1980s both by states increasingly adopting anti-takeover legislation and by companies increasingly adopting poison pills. *See, e.g.*, John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425, 1430-31 (1991). Courts reviewing poison pills eventually understood that poison pills could preclude bidders from purchasing shares tendered by shareholders. *See Interco*, 551 A.2d at 797-98; *Pillsbury*, 558 A.2d at 1053. As a consequence, only if a court forced a board to redeem the poison pill rights could the bidder purchase the target stock. Courts have forced poison pills to be redeemed only twice: the Delaware Chancery Court's *Interco* and *Pillsbury* cases, referred to immediately above. In *Time-Warner*, however, the Delaware Supreme Court seemed to repudiate the doctrinal grounds on which the two Chancery Court opinions were based. *See Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140, 1153 (Del. 1989) ("To the extent that the Court of Chancery has recently [applied the *Unocal* proportionality standard to free shareholders from preclusive takeover defenses in order to allow them to choose between accepting a tender offer and staying with incumbent management] in certain of its opinions, we hereby reject such an approach as not in keeping with a proper *Unocal* analysis."). *Time-Warner* thus seemed to allow boards effectively to preclude shareholders from having their shares purchased by the bidder. *See supra* note 25; *see also Grundfest, supra* note 2, at 858-59.

⁸⁷ *See Grundfest, supra* note 2, at 858-59.

self-interest to make dissolutions work. Bidders must credibly bond that, after a shareholder vote approving dissolution, they will go through with the transaction as indicated; otherwise, shareholders will be less inclined to approve dissolution. In addition, the riskiness of voting for dissolution where no concrete bidder has yet emerged discourages shareholders from voting for dissolution in the absence of a large disparity and the high likelihood of a premium. Moreover, at any one time lenders will make only so much financing available, forcing arbitrageurs and bidders to concentrate on firms where the disparity (and the likely profit) is greatest. Finally, where shareholders retain the right to revoke dissolution, they preclude bidder opportunism.⁸⁸

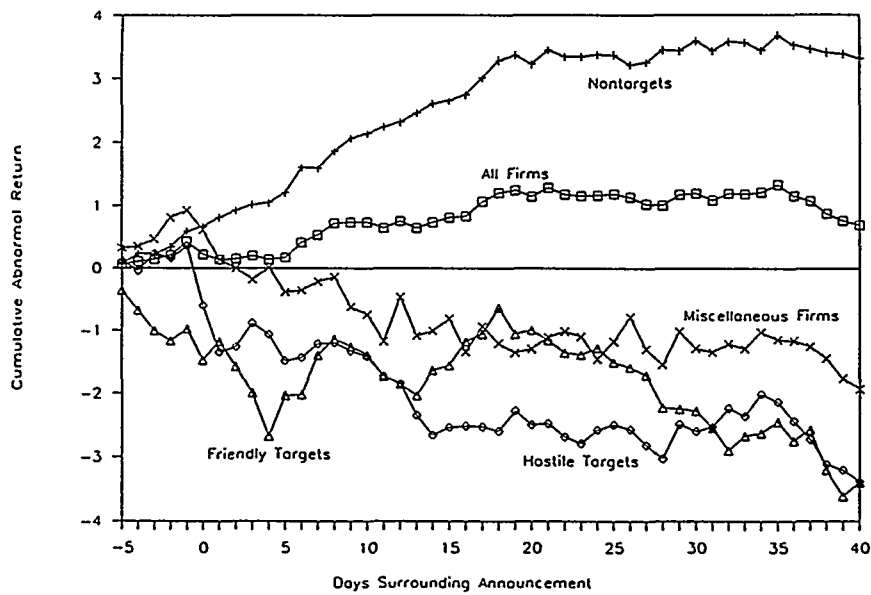
Dissolution, like the hostile takeover, presents the risk that inefficient firms will bid for more efficient firms, thus deploying corporate assets in the wrong direction. Again, market processes offer the best protection. Historically, corporations that pursue value-decreasing acquisitions are themselves taken over with abnormally high frequency.⁸⁹ Bidder management that takes over target corporations and fails to increase their value will increase the disparity in the bidder company's stock, thereby exposing such inefficient bidders to dissolution.⁹⁰

⁸⁸ See *infra* notes 130-39 and accompanying text.

⁸⁹ Mitchell and Lehn found that the stock market negatively values acquisitions by firms that later become takeover targets and positively values acquisitions by firms that do not. See Mitchell & Lehn, *supra* note 73, at 384. Acquisitions made by targets-to-be are later divested at an average 40.7% rate versus only 9.1% for non-targets. See *id.* at 388. Further, "the probability that a firm is a target, especially a hostile target . . . is inversely and significantly related to the stock price effects associated with announcements of the firm's acquisitions: the more negative these effects, the higher the likelihood of a subsequent takeover attempt." *Id.* at 376; see also *infra* Figure 3; Black, *supra* note 9, at 622-23 (arguing that "today's overpaying bidders are likely to be tomorrow's targets"); Morck et al., *supra* note 82, at 34 (citing Mitchell and Lehn). The dissolution regime, by allowing shareholders to punish inefficient acquisitions by voting to dissolve, should discourage such wealth-reducing acquisitions more effectively than have other remedies.

⁹⁰ Lang, Stulz, and Walkling found that the "total takeover gain" (the increase [decrease] in the combined market value of the bidder and target equity) varied depending on management skill as proxied by Tobin's *q*. Tobin's *q* represents "the ratio of the firm's market value to its replacement value" and "is an increasing function of the quality of a firm's current and anticipated projects under existing management." Lang et al., *supra* note 82, at 138-39. Whereas bidders with high Tobin's *q*, on average, reap total takeover gain in excess of 10% when they take over low *q* targets, low *q* bidders, on average, lose in excess of 4% when taking over high *q* targets. See *id.* at 139.

FIGURE 3 Stock Price Reactions to Acquisition Announcements, 1982-86



On the shareholder side, institutional investors will be the repeat players in the dissolution regime. As such, they have every incentive to dissolve only underperforming, rather than effectively managed, companies.⁹¹ Any extra costs from inefficient dissolutions or even from inefficient dissolution *votes* will, after all, come at their expense as shareholders.

Thus, market players will gather the relevant information about the advisability of auctioning the company and disseminate such data to the appropriate parties. Whenever *S*'s actual value sags too far below its potential value in the hands of others, market reactions will, as simply and efficiently as a thermostat, invite dissolution. Because dissolution allows shareholders to trigger the auction themselves, it puts discipline over management in the hands of those who care most intensely: shareholders, rather than bidders or managers.

IV. HOW DISSOLUTION WOULD WORK UNDER STATE LAW

Some states now permit only the board to initiate voluntary dissolution;⁹² others permit shareholders to do so as well.⁹³ Because until now state legislatures have not thought of their dissolution regimes as mechanisms to guarantee corporate health, the current state of the law concerning voluntary dissolution results more from historical accident than from any conscious philosophy. Shareholders will benefit if the law allows them to initiate procedures to voluntarily dissolve their corporations, and state legislatures should change laws, where necessary, to allow them to do so.

Among the twelve states that currently allow shareholders to initiate voluntary dissolution, the most commercially important are California, New York, and Illinois.⁹⁴ To illustrate how dissolution would work under state law, this Part will explain how, under the corporate laws of those three states, shareholders could cause voluntary dissolution even against management wishes. It will

⁹¹ See John C. Coffee, Jr., *Unstable Coalitions: Corporate Governance As a Multi-Player Game*, 78 GEO. L.J. 1495, 1542-44 (1990) (noting that the game theoretical principle that cooperation dominates in iterated or repeated games may apply to institutional investors).

⁹² See *supra* note 12.

⁹³ See *supra* note 13.

⁹⁴ For a limited, rather dated, but generally useful practice-oriented 1983 overview of dissolution focusing on Delaware, New York, and California statutes, see Albert J. Beveridge, III & Cynthia A. Lewis, *Corporate Dissolutions and Liquidations*, 6 CORP. L. REV. 195 (1983).

describe the specific procedures that shareholders would use to effectuate dissolution, the obstacles they would need to avoid, the tactics that management would likely use to try to obstruct dissolution, and the ways shareholders could counter such obstruction. Finally, it will suggest ways legislators could improve legal rules concerning dissolution in order to make it a more efficient regime for corporate discipline.

A. *Do Shareholders Have the Power to Initiate Dissolution?*

1. Current Law

Shareholders of companies incorporated in Illinois, New York, and California can initiate voluntary dissolution without board approval and thereby force the directors to auction their company.⁹⁵

Illinois requires two-thirds of the voting shares to approve dissolution but allows corporations to change that percentage by charter provision.⁹⁶ It should be noted that Illinois contains a

⁹⁵ Delaware allows shareholders holding only a majority of shares to authorize voluntary dissolution, but only if the board has first recommended dissolution. *See* DEL. CODE ANN. tit. 8, § 275(a) (1991). Consequently, this Article will not deal with the Delaware law of dissolution in any detail.

⁹⁶ *See* ILL. ANN. STAT. ch. 805, para. 5/12.15 (Smith-Hurd 1993). Section 12.15 comprises two different substantive provisions regarding voluntary dissolution: (a) provisions concerning *calling* the dissolution vote and (b) provisions concerning the *percentage of votes required* to authorize dissolution. Concerning calling the dissolution vote, § 12.15(a) provides that voluntary

[d]issolution of a corporation may be authorized by a vote of shareholders, in the following manner: (a) Either (1) The board of directors shall adopt a resolution [proposing dissolution] or (2) Holders of not less than one-fifth of all the outstanding shares entitled to vote on dissolution may, in writing, propose the dissolution of the corporation to the board of directors; if the directors fail or refuse to call a meeting of shareholders to consider such proposal for more than one year after delivery thereof, the shareholders proposing dissolution may call a meeting of the shareholders to consider such proposal.

Id. § 12.15(a)(1), (2).

Concerning the actual vote required to authorize dissolution, § 12.15(c) provides that "the resolution to dissolve voluntarily the corporation . . . shall require for its adoption the affirmative vote of the holders of at least two-thirds of the outstanding shares entitled to vote on dissolution." *Id.* § 12.15(c). Section 12.15(d) permits changing the percentage requirement via charter provision. *See id.* § 12.15(d).

Although one can read § 12.15 to allow shareholder-initiated voluntary dissolution against board wishes only where the vote has been called in the manner specified by § 12.15(a), other provisions of Illinois's corporate statute are drafted in such a way to create some ambiguity as to whether shareholders can use other means to effect

potentially powerful provision that management might try to use strategically. Section 12.15(c) provides, in addition to a requirement for a two-thirds supermajority for dissolution, that shareholders can be empowered to vote *as a class*.⁹⁷ The provision requiring separate classes to approve dissolution by supermajority will tempt management to create a separate class of stock, whether common or preferred, with the right to vote on dissolution and issue enough of this special class of stock to block dissolution to itself, a company ESOP or other parties friendly to management. Most states that allow shareholders to initiate dissolution without board approval make similar provisions for voting as separate classes.⁹⁸ Given the transparent entrenchment motive for such special classes of stock, courts normally should invalidate management's issuance of such stock. Better still would be for states to draft provisions, such as New York's, that entitle shareholders to vote as a single group, thereby forestalling management from disenfranchising the majority of shareholders.⁹⁹

Like Illinois, New York requires a two-thirds supermajority to authorize a voluntary non-judicial dissolution¹⁰⁰ and allows the charter to alter the specified percentage.¹⁰¹ Unlike Illinois, New

voluntary dissolution. See *infra* notes 109, 113, 121 and accompanying text.

⁹⁷ Section 12.15(c) provides, in relevant part, that:

the resolution to dissolve voluntarily the corporation . . . shall require for its adoption the affirmative vote of the holders of at least two-thirds of the outstanding shares entitled to vote on dissolution, unless any class of shares is entitled to vote as a class in respect thereof, in which event the resolution shall require for its adoption the affirmative vote of the holders of at least two-thirds of the outstanding shares of *each class* of shares entitled to vote as a class in respect thereof, and of the total outstanding shares entitled to vote on dissolution.

§ 12.15(c) (emphasis added).

⁹⁸ See, e.g., ALASKA STAT. § 10.06.605 (1989); ARK. CODE ANN. § 4-26-710 (Michie 1987); FLA. STAT. ANN. § 607.0704, .1402(6) (West 1993); ILL. ANN. STAT. ch. 805, para. 5/12.15 (Smith-Hurd 1993); LA. REV. STAT. ANN. § 12:142A (West 1994); ME. REV. STAT. ANN. tit. 13-A, § 1103(1)(A)(2) (West 1981); MASS. GEN. LAWS ANN. ch. 156B, § 100(a) (West 1992 & Supp. 1995); N.D. CENT. CODE § 10-19.1-107 (1995); OHIO REV. CODE ANN. § 1701.86(E) (Anderson 1992).

⁹⁹ See, e.g., N.Y. BUS. CORP. LAW § 1001 (McKinney 1986) (authorizing dissolution "by the vote of the holders of two-thirds of *all* outstanding shares entitled to vote thereon" (emphasis added)); cf. CAL. CORP. CODE § 1900 (West 1990) (authorizing dissolution "by the vote of shareholders holding shares representing 50 percent or more of the *voting power*" (emphasis added)). But cf. *infra* note 106 (noting that California currently imposes a supermajority requirement for preferred shareholders to approve dissolution).

¹⁰⁰ See N.Y. BUS. CORP. LAW § 1001 (McKinney 1986).

¹⁰¹ The percentage requirement of § 1001 may be changed in two ways. First, to

York also allows holders of a majority of shares, if "they deem a dissolution to be beneficial to the shareholders," to petition a court to dissolve the corporation judicially.¹⁰² Although judicial dissolution under this provision is not guaranteed, New York law provides that the benefit to the shareholders should govern.¹⁰³ As one prominent commentary notes, "When the proceeding is brought by . . . a majority of the shareholders on their own volition, there will normally be an inference that dissolution will be beneficial to the shareholders."¹⁰⁴

California allows holders of fifty percent or more of the voting shares to authorize voluntary dissolution without board action.¹⁰⁵ Unlike Illinois and New York, California does not allow charter provisions to raise the required percentage of common stock and thus to make dissolution harder to obtain.¹⁰⁶

grant minority shareholders a right to exit their investment, § 1002 allows the charter to specify shareholders who "may require the dissolution of the corporation at will or upon the occurrence of a specified event." *Id.* § 1002(a).

Second, § 616(a)(2) permits the charter to specify a greater proportion of shareholder votes required for action than otherwise prescribed by statute. *See id.* § 616(a)(2).

Normally, corporations would not have or retain such provisions when they go public. However, to the extent that dissolution becomes an effective form of discipline, management will attempt to raise, via charter amendment, the percentage of shares required to approve a dissolution. Shareholders should resist raising the percentage required.

On the other hand, it is assumed that § 1002 allows a charter provision *reducing*, as well as expanding, the percentage required to approve dissolution. *See* Daniel H. O'Connell, *Dissolution As a Remedy for Dissension and Deadlock in the New York Closely-Held Corporation*, 19 BUFF. L. REV. 585, 596 n.70 (1970) (citing Robert A. Kessler, *Arbitration of Intra-Corporate Disputes Under New York Laws*, 19 ARB. J. 1, 14 (1964), as suggesting the possibility that shareholders could vote to reduce the required percentage). Shareholders, therefore, should press for a charter amendment lowering the percentage requirement required for dissolution.

¹⁰² N.Y. BUS. CORP. LAW § 1103(a) (McKinney 1986). Section 1103(c) provides, however, that the charter may require a greater proportion than a majority. *See id.* § 1103(c). The cautions noted above with respect to the interplay of §§ 1001 and 1002 apply, *mutatis mutandis*, to the interplay between §§ 1103(a) and 1103(c).

¹⁰³ *See id.* § 1111(b)(2) (stating that when shareholders petition the court for dissolution, the court must consider that "the benefit to the shareholders of a dissolution is of paramount importance").

¹⁰⁴ 4 ISIDORE KANTROWITZ & SOL SLUTSKY, WHITE ON NEW YORK CORPORATIONS ¶ 1111.01[2] (Jonathon M. Hoff et al. eds., 13th ed. 1995) [hereinafter WHITE ON CORPORATIONS] (citing *In re Niagara Ins. Co.*, 1 Paige Ch. 258, 259 (N.Y. Ch. 1828)); *see also In re Importers' & Grocers' Exch.* (Hitch v. Hawley), 30 N.E. 401, 403-04 (N.Y. 1892).

¹⁰⁵ *See* CAL. CORP. CODE § 1900(a) (West 1990).

¹⁰⁶ Section 204 allows charter provisions to increase the percentage of votes required for certain corporate actions but specifically excludes corporate actions

2. Possible Improvements

States would increase shareholders' and other constituencies' welfare by allowing shareholders to initiate voluntary dissolution even against management's wishes. Those states that currently do not permit shareholder-initiated dissolution should revise their statutes to grant shareholders such a right. Further, states should allow such action by vote of a simple majority. Supermajority provisions permit insiders with substantial holdings to frustrate the will of the majority.¹⁰⁷ To prevent strategic blocking, states should not allow charter amendments to raise the percentage required for approving voluntary dissolution above an affirmative majority for common stock, unless shareholders can initiate changes to charter provisions to protect themselves from managerial entrenchment. In addition, states should require that charter provisions allowing class voting on dissolution to be subject to shareholder approval. Where shareholders approve separate classes being able to vote on dissolution, so as to prevent managerial opportunism, states should allow holders of two-thirds of the total voting power to override any class's veto of dissolution. Finally, preferred stockholders should not be allowed to block dissolution, although measures should protect their interests from opportunism by common stockholders.¹⁰⁸

taken pursuant to § 1900, the section allowing shareholders to dissolve the corporation. *See id.* § 204(a)(5). For an argument that the structure of California's Corporations Code would permit shareholders to adopt provisions reducing (though not increasing) the required percentage for a voluntary dissolution, see Edwin J. Bradley, *A Comparative Assessment of the California Close Corporation Provisions and a Proposal for Protecting Individual Participants*, 9 LOY. L.A. L. REV. 865, 891-93 (1976).

Note that California law creates a possible ploy (akin to that created by Illinois law, *see supra* note 97 and accompanying text) that management will be tempted to use to block dissolution. California's § 402.5(b) allows corporate charters to include provisions requiring a supermajority of *preferred* stock, not to exceed two-thirds, to approve dissolution. *See* CAL. CORP. CODE § 402.5(b) (West 1990). Management may be tempted to create a class of such preferred stock with the right to block dissolution with only one-third of the preferred shares and then to acquire a blocking position in the preferred stock. Shareholders should, naturally, resist such managerial action. If solicited to authorize "blank check" preferred stock, shareholders should refuse, unless provisions are included to protect common shareholders' practical ability to dissolve the corporation.

¹⁰⁷ Concerns that minority shareholders need supermajority provisions to prevent oppression by the majority are unwarranted because minority shareholders who receive disparate, unfavorable treatment can petition the court to have the dissolution annulled or revoked. *See infra* notes 125-27 and accompanying text.

¹⁰⁸ One expedient to protect preferred shareholders is to deem a shareholder-initiated dissolution the legal equivalent of a liquidation, thereby entitling preferred shareholders the right to the return of their investment plus any accrued but unpaid

B. *How Can Shareholders Call a Meeting and
Vote on Dissolving the Corporation?*

1. Current Law

There are four circumstances in which shareholders can authorize dissolution: (1) at the regular annual meeting of shareholders, (2) at a special meeting of shareholders unrelated to dissolution, (3) at a special meeting of shareholders specifically related to dissolution, and (4) by written consent in lieu of a meeting.

a. *Annual Meeting of Shareholders*

Where time is not of the essence, the annual meeting of shareholders provides the best opportunity for shareholders to call for dissolution. Corporate law allows shareholders at an annual meeting to vote on any matter appropriate for shareholder action.¹⁰⁹ Through a simple vote, shareholders holding the

dividends. (Such a constructive liquidation may be needed because most dissolutions will probably result in mergers, which do not trigger preferred shareholders' preferences in liquidation.)

¹⁰⁹ New York law provides that "[a] meeting of shareholders shall be held annually for the election of directors *and the transaction of other business* on a date fixed by or under the by-laws." N.Y. BUS. CORP. LAW § 602(b) (McKinney 1986) (emphasis added).

California law provides that "in the case of the annual meeting, . . . subject to the provisions of subdivision (f) [requiring notice for certain transactions, including voluntary dissolution pursuant to § 1900] any proper matter may be presented at the meeting for such action." CAL. CORP. CODE § 601(a) (West 1990).

Although the Illinois statute does not explicitly state that shareholders may present any proper subject at the annual meeting, the structure of the statute implies that they can. For example, § 7.05 provides that "[s]pecial meetings of the shareholders may be called . . . by the holders of not less than one-fifth of all the outstanding shares entitled to vote on the matter for which the meeting is called." ILL. ANN. STAT. ch. 805, para. 5/7.05 (Smith-Hurd 1993). The statute's grant to shareholders of the ability to call a special meeting at which they present matters for a vote implies that shareholders may introduce at annual shareholder meetings motions on matters on which they have the statutory power to act.

The question is whether Illinois § 12.15 constitutes the sole means by which shareholders can initiate voluntary dissolution or if it merely guarantees that right against recalcitrant boards, leaving other avenues open for shareholders to trigger dissolution. If shareholder-initiated dissolution votes are restricted to the method set forth in § 12.15(a), shareholders could not immediately trigger a dissolution vote at the annual meeting, even if holders of 20% of the shares presented them in favor of the vote. *See* ILL. ANN. STAT. ch. 805, para. 5/12.15(a)(2) (Smith-Hurd 1993). Strong policy reasons support reading the statute in favor of shareholders wishing to bypass board obstruction. Holders of 20% of the voting stock will surmount collective action

percentage of shares required under the applicable state law¹¹⁰ can call for a vote on dissolution.

b. *Special Meetings of Shareholders (Unrelated to Dissolution)*

Where timing is more important, shareholders may prefer to call a special shareholders' meeting to vote for dissolution. All states provide for special meetings of shareholders, but not all states allow shareholders to call a special meeting. Under many state regimes, shareholders can call special meetings on their own only if the corporation's charter or bylaws affirmatively so provide. In the absence of such express rights, shareholders must wait until the board calls a meeting or until the next scheduled annual meeting.¹¹¹

Other states guarantee holders of a specified percentage of shares the right to call special shareholder meetings.¹¹² Illinois gives this right to shareholders owning twenty percent of the voting stock.¹¹³ California's current law is more liberal towards shareholders and allows holders of ten percent of the voting power to call special meetings.¹¹⁴

problems and present their shares requesting a dissolution vote only after management has dissipated significant corporate wealth. Consequently, courts should read the statute liberally in order to grant shareholders the power to initiate dissolution free from board obstruction and delay, thereby protecting shareholders from further wealth erosion.

¹¹⁰ Typically, as long as a shareholder has the financial wherewithal to call for the vote, she can do so. This liberality has led to crank proposals for dissolution. See *infra* note 123. Under a more optimal regime, dissolution votes could be called only by holders of a substantial percentage of shares. See *infra* notes 123-24 and accompanying text.

¹¹¹ New York law, for example, allows shareholders to call a special meeting only if the charter or bylaws so provide. See N.Y. BUS. CORP. LAW § 602(c) (McKinney 1986). Shareholders of New York corporations should, where necessary, alter the organic documents to grant themselves the right to call special meetings.

See also DEL. CODE ANN. tit. 8, § 211(d) (1975) (allowing only the board and persons authorized by charter or bylaws to call special shareholder meetings).

¹¹² In addition to Illinois and California, cited below (see *infra* notes 113-14), see, e.g., REVISED MODEL BUSINESS CORP. ACT ("RMBCA") § 7.02 (1985) (allowing, in addition to the board and persons authorized by charter or bylaws, the holders of at least 10% of votes to call a special meeting).

¹¹³ See ILL. ANN. STAT. ch. 805, para. 5/7.05 (Smith-Hurd 1993) (granting the right to call special meetings to "the holders of not less than one-fifth of all the outstanding shares entitled to vote on the matter for which the meeting is called"). Again, the critical question is whether shareholders can call for voluntary dissolution other than through § 12.15. See *supra* note 109; *infra* note 121.

¹¹⁴ See CAL. CORP. CODE § 600(d) (West 1990). The 1975 statute reduced the percentage of shareholders required to call a special meeting from 20% to 10% in

c. *Special Meeting Specifically for the Purpose of Voting on Dissolution*

In addition to providing for special meetings generally, Illinois specifically allows holders of twenty percent of the company's shares to propose voluntary dissolution.¹¹⁵ If the board refuses for one year to call a meeting to vote on the question, the proposing shareholders may themselves call a shareholder meeting and a vote.¹¹⁶ New York also grants holders of ten percent of the stock the indefeasible right to cause shareholders to vote on whether "they deem a dissolution to be beneficial" to themselves and to petition a court to dissolve the corporation on such grounds.¹¹⁷ California, with its liberal provisions allowing holders of ten percent of shares to call for special meetings, does not provide for special meetings specifically related to voluntary dissolution.

d. *Written Consent in Lieu of a Meeting*

Finally, most states allow shareholders to act by signing written consents, rather than by voting at a shareholder meeting. In the most restrictive regimes, written consents can substitute for shareholder meetings only if signed by holders of *all* of the shares. New York follows this pattern.¹¹⁸ Because management will always own some stock, unanimity is impossible.

Illinois has two separate regimes for written consents. In section 12.10, Illinois specifically allows shareholders to voluntarily dissolve

order "[t]o facilitate and expand upon the right to call a special meeting of the shareholders." *Id.* legislative committee cmt.

¹¹⁵ See ILL. ANN. STAT. ch 805, para. 5/12.15(a)(2) (Smith-Hurd 1993).

¹¹⁶ See *id.*

¹¹⁷ See N.Y. BUS. CORP. LAW § 1103(b) (McKinney 1986).

This right should prove more important in a popular movement to dissolve a New York corporation than it might first appear. Superficially, the right merely entitles 10% of the shareholders to cause a court to consider judicially dissolving the corporation. The court still has, from the shareholders' viewpoint, an uncomfortable degree of discretion over whether to order dissolution. The court's discretion should, however, be irrelevant: the initial proponent's call for dissolution triggers a shareholder vote whether to approve dissolution. If more than two-thirds of the shares vote for dissolution, that vote satisfies the requirements of § 1001, and the dissolution should be forthcoming without the review of the court. See *supra* note 100 and accompanying text.

Naturally, if management attempts to thwart non-insider shareholders by voting shares held or controlled by them against the dissolution, the court should give special weight to the disinterested shareholders' wishes in deciding, pursuant to § 1103, whether to grant judicial dissolution.

¹¹⁸ See N.Y. BUS. CORP. LAW § 615(a) (McKinney 1986).

the corporation by written consent but requires unanimity.¹¹⁹ Section 7.10(a) allows general shareholder action by non-unanimous written consent.¹²⁰ Although section 7.10(a) seems to exclude shareholder-initiated voluntary dissolution from its scope, its drafting leaves unresolved the question of whether shareholders could use this second, more liberal consent provision for triggering a dissolution vote.¹²¹

Other states allow more liberal use of written consents, although usually allowing the corporation's charter to restrict their use. California, for example, allows shareholders to act by written consent of the holders of voting shares sufficient to authorize the action at a meeting, unless the charter provides to the contrary.¹²²

¹¹⁹ See ILL. ANN. STAT. ch. 805, para. 5/12.10 (Smith-Hurd 1993) (permitting "[d]issolution of a corporation [to] be authorized by the unanimous consent in writing of the holders of all outstanding shares entitled to vote on dissolution").

¹²⁰ See ILL. ANN. STAT. ch. 805, para. 5/7.10(a) (Smith-Hurd 1993) (permitting "any action required by this Act to be taken at any annual or special meeting of the shareholders" by written consent "by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting").

¹²¹ Section 7.10(a) allows action by written consent "[u]nless otherwise provided in the articles of incorporation or Section 12.10 of this Act." ILL. ANN. STAT. ch. 805, para. 5/7.10(a) (Smith-Hurd 1993). Section 12.10 of the Act provides only that shareholders acting unanimously via written consent can dissolve the corporation, *see supra* note 119; it does not, however, by its terms preclude other sections of the Act from authorizing shareholder-initiated dissolution by less than a unanimous vote. Consequently, although the legislature drafted § 7.10(a) so as to preclude shareholders from using written consents for dissolution *if* § 12.10 provides otherwise, it did not draft § 12.10 so as to "provide otherwise."

The Illinois statute expressly allows shareholders to dissolve the corporation subject to the board's delay. *See supra* note 96. Read literally, the Illinois statute leaves unresolved whether shareholders can dissolve the corporation without waiting a year for the board to act. This ambiguity derives from § 12.15's dichotomy between provisions for calling for the vote and provisions specifying what percentage is required to authorize dissolution. *See supra* note 96. Although § 12.15(a)'s provisions specifying how to *call* the meeting clearly allow the board to delay calling the vote for a year, other sections in the statute that authorize shareholder action speak only of obtaining the *required percentage* of shares and do not impose limits on calling the matter to a vote. Section 7.10(a) allows written consent "by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting." *See supra* note 120. Section 12.15(c) specifies that two-thirds of the outstanding voting shares would suffice to authorize or take the action of voluntary dissolution. *See supra* note 96. Arguably, § 7.10(a)'s requirements would be fulfilled by written consent by holders of two-thirds of the voting shares.

¹²² See CAL. CORP. CODE § 603(a) (West 1990).

Whether written consents are useful depends on the corporation's charter. Management's mergers and acquisitions specialists typically recommend adopting charter provisions removing shareholders' ability to act by written consents. Share-

2. Possible Improvements

States should guarantee shareholders the ability to call dissolution votes. First, states should empower holders of a specified percentage of the corporation's common stock to call special shareholder meetings for dissolution votes. In order to deter frivolous disruption of the corporation,¹²³ states should require a relatively high threshold percentage of shareholdings for calling a dissolution vote: for example, ten percent of the shares or, in the absence of other impediments to shareholder autonomy, such as poison pills and anti-takeover statutes, even twenty percent.

The percentage requirement for calling a dissolution vote should be less for annual meetings than for special meetings. Given that the corporation's transaction costs for the meeting are already "sunk," any significant additional costs associated with a vote on dissolution will reflect shareholder dissatisfaction with management. These incremental costs are no reason to increase *shareholders'* difficulty in calling for a dissolution at the annual meeting. Thus, ten percent of the shares should suffice to force a vote on dissolution at the annual shareholder meeting.

To prevent waste, the law could limit the frequency of dissolution votes. New York's provision restricting meetings to vote on petitioning the court for judicial dissolution to only once in any twelve-month period¹²⁴ makes sense and may warrant application to all dissolution votes. While any particular time period required before shareholders may again call for a dissolution vote will be somewhat arbitrary, the required delay should strike a balance between discouraging wasteful repetition of dissolution votes and impeding legitimate shareholder wishes. The one-year period would seem to satisfy both goals.

holders, naturally, should resist such amendments and, where they are present, press for their removal.

¹²³ For an example of a crank Rule 14a-8 shareholder proposal recommending dissolution, see Exxon Corp., SEC No-Action Letter (Feb. 19, 1974), 1974 SEC No-Action Letter LEXIS 1669, at *5 (recommending that Exxon Corporation's holding company be dissolved because other holding companies, such as "Pen-Central [sic]," had experienced bankruptcy or financial difficulty). The proponent had made a similar shareholder proposal concerning First National Boston Corporation in 1973. See First Nat'l Boston Corp., SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,252, at 82,751-53 (Jan. 30, 1973).

¹²⁴ N.Y. BUS. CORP. LAW § 1103(b) (McKinney 1986) (providing that a shareholder meeting to petition the court for judicial dissolution "may not be called more often than once in any period of twelve consecutive months").

In addition, the required delay would provide an important informational function, helping shareholders discriminate between share price increases due to new information about the company's stand-alone value in the hands of incumbent management and increases due to risk arbitrage in anticipation of an auction. Where investors purchase solely in anticipation of a premium-inducing auction but the dissolution vote fails, the knowledge that shareholder-initiated dissolution cannot occur for another year will discourage many investors from holding the stock. To the extent they respond by selling the stock, the share price will revert toward the pre-dissolution-vote level, indicating that the company's stand-alone value in the hands of incumbent management is less than its value at auction.

*C. Are There Equitable Grounds to Stop Voluntary Dissolution,
Despite Compliance with Procedural Requirements?*

Corporate law embraces the principle that courts may strike down actions that comply strictly with a statute, if such actions promote inequitable consequences.¹²⁵ Could voluntary dissolution authorized by majority shareholders be inequitable?¹²⁶ The potential victims of inequitable treatment are: (i) minority share-

¹²⁵ See, e.g., *Schnell v. Chris-Craft Indus.*, 285 A.2d 437 (Del. 1971) (judicially nullifying management's rescheduling of the annual stockholders' meeting as inequitable, even though legally permissible). Early analyses of the majority's improper use of procedurally correct rights have appropriately urged that because procedures such as dissolution can be used to freeze out minority shareholders, courts must be ready to intervene to forestall unequal treatment. See Norman D. Lattin, *Equitable Limitations on Statutory or Charter Powers Given to Majority Stockholders*, 30 MICH. L. REV. 645, 646 (1932). Lattin's article raises other concerns, however, that seem archaic and unfounded: for example, railing against the "increasing danger of [the majority's] selling out for the purpose of making a profit on shares," *id.* at 659, or the purported "right of the minority to stay with the corporation in its new form" after merger or dissolution, *id.* at 663. The modern evolution of the law has narrowed the focus to that of equal treatment and vigilance against unfair self dealing. For historical discussion of this shift in the law's concerns, see, e.g., Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223 (1962); Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624 (1981).

¹²⁶ An early commentator stressed that voluntary dissolution's third-party effects would disadvantage the non-insiders by cutting down on the time period within which insiders could be sued and introducing procedural advantages to insiders. See George D. Hornstein, *Voluntary Dissolution—A New Development in Intracorporate Abuse*, 51 YALE L.J. 64, 69 (1941). Subsequent to Hornstein's article, states have taken action to give relatively precise protections to third parties, but calls to expand those protections continue. See Hogan, *supra* note 41, at 168-70.

holders and (ii) non-shareholder creditors.

If a controlling shareholder uses voluntary dissolution to exploit minority shareholders, the law will intervene to protect the minority.¹²⁷ Equity concerns should be satisfied and judicial intervention should be unwarranted, however, when the proceeds of any sale, merger, or liquidation are distributed pro rata among the shareholders without differentially advantaging some shareholders over others. Under the current proposal, shareholders of *S* would receive their ratable share of the dissolution proceeds, and thus all shareholders would benefit alike.

A separate question is whether courts should enjoin dissolution due to its effect on non-shareholder third parties. Quite reasonably, statutory provisions require that the dissolving corporation satisfy or make provision for all of its liabilities before the corporation makes distributions to shareholders.¹²⁸ Beyond that principle, current law does not provide non-shareholder constituencies more than those entitlements for which they have negotiated.¹²⁹ This

¹²⁷ See, e.g., *Whitman v. Fuqua*, 549 F. Supp. 315, 322-23 (W.D. Pa. 1982) (explaining the court's authority to appoint a receiver or custodian when necessary to protect the interests of minority shareholders); *Kavanaugh v. Kavanaugh Knitting Co.*, 123 N.E. 148, 152 (N.Y. 1919) (explaining that stockholders "cannot use their corporate power in bad faith or for their individual advantage or purpose"); *Martin v. Donghia Assocs.*, 424 N.Y.S.2d 222, 224 (App. Div. 1980) (mem.) (upholding an injunction against the majority shareholder where "the majority shareholder [was] charged with corporate wrongdoing"); WHITE ON CORPORATIONS, *supra* note 104, ¶ 1001.03 (citing cases therein); Thompson, *Shareholders' Reasonable Expectations*, *supra* note 41, at 237 (recognizing the "broader grounds" for which courts will order remedies to protect minority shareholder interests).

¹²⁸ Where liabilities are not assumed by action of a merger, the practical difficulties providing for satisfaction of liabilities can be considerable. For description of these practical difficulties, see Ann E. Conaway Stilson, *Reexamining the Fiduciary Paradigm at Corporate Insolvency and Dissolution: Defining Directors' Duties to Creditors*, 20 DEL. J. CORP. L. 1 (1995). For the merger's avoidance of this problem, see *infra* note 155.

¹²⁹ An early form of New York's statutory provisions regarding dissolution directed courts to judge whether dissolution would be both "beneficial to the stockholders . . . and not injurious to the public." See WILLIAM L. CARY & MELVIN A. EISENBERG, *CASES AND MATERIALS ON CORPORATIONS* 446 (6th ed. 1988) (citing New York's General Corporations Law § 117, predecessor of N.Y. BUS. CORP. LAW § 1104 (McKinney 1986)) (emphasis added). A judicially activist New York decision reviewing a petition for judicial dissolution focused on non-shareholder interests and refused to order dissolution despite its benefits to the shareholders. See *In re Radom & Neidorff, Inc.*, 119 N.E.2d 563, 565 (N.Y. 1954). Subsequently, the New York legislature changed the statute to require that only shareholders' interests be considered. See N.Y. BUS. CORP. LAW § 1104 (omitting reference to non-shareholder considerations, though leaving judicial dissolution discretionary with the court); see also WHITE ON CORPORATIONS, *supra* note 104, ¶ 1103.01 ("Non-

principle should remain. Optimal management of the corporation, encouraged by the threat of dissolution, supplies the best protection for non-shareholder interests. Allowing non-shareholders to prevent voluntary dissolution would rescue the very managements that dissolution should displace. Such managements would likely invoke other parties' interests in order to save their own jobs, even as they render the corporation weaker and less able, over the long term, to satisfy its obligations.

shareholders will generally be prohibited from participating in the proceedings."); Note, *Dissolution of the Close Corporation*, 41 ST. JOHN'S L. REV. 239, 244 (1966) ("[T]he provision for non-injury to the public has been deleted."). Accordingly, where shareholders approve the dissolution by a supermajority sufficient to make the dissolution a matter of right rather than of judicial discretion, the court should not intervene. Thus, voluntary dissolution should not be vulnerable to judicial meddling in New York.

The same conclusion holds for Illinois. It should also hold for California, although dicta in some California decisions create some confusion. Certain California opinions in which courts were attempting to fashion novel theories of fiduciary duties contain dicta suggesting that courts should consider whether dissolution would benefit parties other than shareholders. These theories were not supported by statute and have either created unwarranted and gratuitous additions to conditions for dissolution or have been made in cases that have not involved dissolution. See, e.g., *In re Security Fin. Co.*, 317 P.2d 1, 6 (Cal. 1957) (demonstrating that the dissolution in question was being carried out in "good faith" by mentioning unnecessarily that, in addition to the traditional requirement that "no advantage is secured over other shareholders," the facts that "in this case, all alternative methods are foreclosed, . . . and no rights of third parties will be adversely affected"); *Jones v. H.F. Ahmanson & Co.*, 460 P.2d 464, 471, 473 (Cal. 1969) (misquoting *Security Finance*, so as to expand the sweep of fiduciary duties in a case not involving dissolution, to state, "We recognized [in *Security Finance*] that the majority had the right to dissolve the corporation to protect their investment if no alternative means were available and no advantage was secured over other shareholders . . ."); *Crain v. Electronic Memories & Magnetics Corp.*, 50 Cal. App. 3d 509, 522 (Ct. App. 1975) (repeating the dictum from *Ahmanson*, despite the fact that it was irrelevant to the case at bar, which involved a sale of corporate assets rather than a dissolution). Although the requirement that the majority secure no benefit over the minority shareholders seems self-evident, nothing in *Security Finance* necessitated or even invited the requirement that no other alternative to dissolution be available. The *Security Finance* dictum had nothing to do with the facts of *Ahmanson* or *Crain* and was used in the later cases to provide judicial momentum to override majority action otherwise difficult for the court to address directly. A requirement of more than equitable protection of minority shareholders should be discarded as judicial overreaching.

D. *Could a Corporation Revoke Dissolution
Once Stockholders Approved It?*

1. Current Law

States differ on how, if at all, a corporation can revoke a shareholder-initiated dissolution. If the board could revoke the dissolution, it could nullify the shareholders' action. Presumably, a court would eventually stop the board from undoing the shareholders' action, but litigation over the matter is undesirable.

New York and California provide little resistance to shareholder-initiated dissolution. In New York, neither directors nor shareholders can revoke corporate dissolution by normal corporate action.¹³⁰ New York does allow a court, upon the petition of the corporation or of certain other third parties, to annul the dissolution.¹³¹ Where the dissolution has not disadvantaged minority shareholders, creditors, or other claimants, though, the court has no reason to intervene. Only if *shareholders* initiated the petition to annul the dissolution should a court even consider a petition from "the corporation" to annul the dissolution.¹³²

In California, revocation is possible but does not threaten shareholder sovereignty over dissolution. While shareholders can revoke dissolutions generally, the board may revoke only board-

¹³⁰ See WHITE ON CORPORATIONS, *supra* note 104, ¶ 1004.04 (noting that after the department of state has filed a corporation's certificate of dissolution "[t]here is no provision by which the dissolution . . . can be revoked"); see also HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES 994 n.21 (3d ed. 1983) (explaining that in New York "once the articles of dissolution are filed, the corporation is dissolved and such dissolution cannot be revoked").

¹³¹ New York law provides that, after the filing of the certificate of dissolution, the supreme court "upon the petition of the corporation, or, in a situation approved by the court, upon the petition of a creditor, claimant, director, officer, shareholder, subscriber for shares, incorporator or the attorney-general, may suspend or annul the dissolution." N.Y. BUS. CORP. LAW § 1008(a) (McKinney 1986). The issues enumerated in § 1008 include procedural correctness, adequacy of notice, and provision for satisfying claims. See *id.* § 1008. Presumably, directors and officers are empowered to protect their own rights and those of other persons that might be damaged by an unfair *distribution* of the proceeds of the dissolution, but § 1008 does not entitle non-shareholders to negate a valid shareholder vote because they disagree with its advisability. See *id.*

¹³² For certain tactical reasons, it is probably advisable to permit shareholders to revoke dissolutions that they approved earlier. See *infra* notes 138-39 and accompanying text.

initiated dissolutions.¹³³ The statute does not contemplate the board revoking a voluntary dissolution by the shareholders.¹³⁴

The Illinois statute clearly contemplates shareholders initiating and authorizing voluntary dissolution without board action (and, implicitly, against board wishes)¹³⁵ and appears to allow shareholders to revoke dissolution once it has been called.¹³⁶ Surprisingly, however, Illinois also allows the board, without shareholder action, to revoke a dissolution, a situation that invites management to frustrate shareholders' wishes.¹³⁷

2. Possible Improvements

The law should allow only shareholders to revoke or annul dissolution, protecting creditors' and workers' entitlements by statutory provisions that guarantee the benefits of bargains actually made. When they vote on whether to dissolve, shareholders should choose whether to bind themselves to accept the best deal the board obtains or to preserve the right to revoke the dissolution. Without this choice, there is the risk that dissolution could expose share-

¹³³ See CAL. CORP. CODE § 1902(a) (West 1990).

¹³⁴ Revoking dissolution should not be confused with rejecting a specific transaction. California allows shareholders to turn down specific offers without thereby freeing management from auctioning the company. California's statute requires that shareholders approve dispositions of the corporation other than for cash. See *infra* note 146 and accompanying text. In addition, 90% supermajority shareholder approval is required for purchases by insiders. See *infra* note 147 and accompanying text.

¹³⁵ See *supra* note 96.

¹³⁶ Illinois provides that "[a] corporation may revoke its dissolution within 60 days of the effective date of dissolution if the corporation has not begun to distribute its assets or has not commenced a proceeding for court-supervision of its winding up." ILL. ANN. STAT. ch. 805, para. 5/12.25(a) (Smith-Hurd 1993). Although the statute leaves open who is empowered to act as the "corporation," it would seem, in light of shareholders' ability to initiate dissolution and of paragraph 5/12.25(b) discussed below, that shareholders could take action to revoke the dissolution.

¹³⁷ Illinois provides as follows: "The corporation's board of directors . . . may revoke the dissolution without shareholder action." *Id.* para. 5/12.25(b).

This provision would seem to represent a drafting oversight. It is efficient to allow management to revoke a management-initiated dissolution after the shareholders approve so as to give management flexibility up to the last moment, just as merger provisions typically allow boards to abandon mergers even after shareholder approval. However, where the shareholders dissolve the corporation in spite of board opposition, it makes little sense to allow the board, via revocation, to override the shareholders' choice. The current wording of the statute should be amended or judicially reformed. Until it is corrected, it poses a potentially significant obstacle to shareholders of Illinois corporations to use voluntary dissolution.

holders to strategic behavior by bidders, on the one hand, or by management, on the other.

Powerful arguments support shareholders retaining the right to revoke. If *S*'s shareholders can revoke dissolution, then they do not risk seeing *S* liquidated wastefully if no bidders make satisfactory offers or if bidders change their offers after shareholders have voted to dissolve. Accordingly, allowing shareholders to revoke the dissolution gives them a final say on the terms, including price, of the deal, similar to shareholders' right to vote on a merger agreement negotiated by the board.

Strong arguments against shareholder revocation also exist. First, bidders expend significant resources in their attempt to acquire a corporation. Permitting shareholders to revoke dissolution after bidders and independent directors have agreed on price and structure will reduce bidders' incentives to bid. Two important factors ease the effects of this problem: (i) market participants will have already expended the search costs to identify the appropriate target, and (ii) the dissolution regime, by forcing the auction, eliminates most of the expenses of a takeover battle. Additionally, the target board could bind itself to pay the winning bidder some reasonable termination fee if shareholders revoke the dissolution.

The possibility that management, hoping to resume control after shareholders revoke dissolution, might manipulate the auction process to guarantee an unsatisfactory bid presents a second, more serious argument against allowing revocation.¹³⁸ Normally, once dissolution forces an auction, independent directors' integrity will protect shareholders from management's strategic behavior. Where shareholders dissolve the company to displace opportunistic management, however, the existing directors have likely acquiesced to the insiders' opportunism and may lack trustworthiness. If the shareholders can bind themselves to taking the highest bid, they thereby eliminate directors' incentives for mishandling the auction.

One possible solution to this dilemma would allow shareholders to precommit to the strategy that they believe will best serve them. Movement in the corporation's stock price will inform shareholders how to act. When they vote, responding to the market's reaction to the prospect of dissolution, shareholders could choose: (a) not to dissolve, (b) to dissolve with the possibility of revocation, or (c) to

¹³⁸ See EASTERBROOK & FISCHER, *supra* note 1, at 169 (describing auction practices that can prevent the sale of a corporation).

dissolve and bind themselves to accept the highest price offered, relinquishing any right to revoke the dissolution. If shareholders vote an affirmative majority of shares both to dissolve *and* to relinquish the right to revoke, they will be bound to take the highest bid, no matter what its amount. If shareholders vote an affirmative majority of shares to dissolve, but fewer than a majority to relinquish the right to revoke, they will retain the right, on learning the highest bid, to revoke dissolution.¹³⁹

The law should distinguish between situations in which shareholders disfavor a particular offer and situations in which shareholders revoke the dissolution process itself. Certain states require that shareholders approve specific types of transactions, such as sales for consideration other than cash¹⁴⁰ or sales to insiders.¹⁴¹ Such provisions should invite a narrow construction so as to apply only to the specific transaction voted on and not to the issue of whether or not to dissolve. For shareholders to revoke the dissolution, they must explicitly so vote. Thus, absent explicit revocation, shareholder rejection of a particular offer would have the effect of forcing management to conduct the auction again.

E. *How Should the Board Conduct the Auction?*

1. Current Law

Once shareholders authorize dissolution, the board of directors must dispose of the corporation's assets, pay or provide for corporate liabilities, and distribute the residue to the shareholders. Following dissolution, a corporation may not engage in any substantial new business. In fact, the law restricts corporate activities to obtaining the best price for the shareholders and winding up its affairs.¹⁴² The wording of many dissolution statutes

¹³⁹ For example, where two or more bidders bid aggressively such that before the vote the premium is large, shareholders would likely want to bind themselves to the highest price so as to encourage unconstrained bidding. Where shareholders are attempting to rid themselves of opportunistic management, they likely will also want to bind themselves to taking the highest bid, thereby precluding management from any hope that by fouling the auction, it can regain power. Where, on the other hand, the stock price movement is ambiguous and shareholders worry that the final price will be unacceptable, they could vote for the dissolution, subject to their right to revoke the dissolution after learning the final price.

¹⁴⁰ See *infra* note 146 and accompanying text.

¹⁴¹ See *infra* note 147 and accompanying text.

¹⁴² On the issue of a corporation conducting business following dissolution, California law provides:

is vague: legislatures typically phrase the provisions permissively, allowing the board to marshal the assets and sell them in various ways.¹⁴³ Left unsaid, but clearly implicit, is the notion that the board should obtain the best available price for the corporation.

California's dissolution provisions give directors more flexibility in auctioning the corporation than those found in New York or Illinois. The California statute clearly expresses the board's duty to maximize the benefit to shareholders and allows considerable discretion in structuring the company's disposition.¹⁴⁴ So long as the board sells the assets for cash to an independent, third-party buyer, the board can sell all or any part of the corporation's assets without the approval of shareholders.¹⁴⁵ If, however, directors wish to dispose of the corporation through merger, consolidation, share exchange, or sale of assets for any consideration other than cash, they must secure shareholder approval for such transactions.¹⁴⁶ Additionally, for certain dispositions to insiders, Califor-

When a voluntary proceeding for winding up has commenced [upon the adoption of the shareholder resolution electing to dissolve], the corporation shall cease to carry on business except to the extent necessary for the beneficial winding up thereof and except during such period as the board may deem necessary to preserve the corporation's goodwill or going-concern value pending a sale of its business or assets, or both, in whole or in part.

CAL. CORP. CODE § 1903(c) (West 1990).

New York law provides: "(a) After dissolution: (1) The corporation shall carry on no business except for the purpose of winding up its affairs." N.Y. BUS. CORP. LAW § 1005(a) (McKinney 1986). Illinois law provides that "a dissolved corporation shall not thereafter carry on any business except that necessary to wind up and liquidate its business and affairs." ILL. ANN. STAT. ch. 805, para. 5/12.30 (Smith-Hurd 1993).

¹⁴³ See, e.g., *infra* notes 148, 150.

¹⁴⁴ See CAL. CORP. CODE § 1903(c) (West 1990), reproduced *supra* note 142. Courts should read the statute's command for the board to sell the corporation's "business or assets, or both, in whole or in part" liberally. *Id.* If a sale of the corporation in its entirety would constitute the most "beneficial winding up thereof," the board should sell the corporation's "business . . . in whole." *Id.* It should be noted that other parts of the statute refer solely to selling assets. See, e.g., CAL. CORP. CODE § 2001(g) (West 1990). There is no practical reason why the board should not simply arrange for the acquisition of the corporation most advantageous for the shareholders, including by way of statutory merger. Using the typical merger technique would convey all assets and liabilities to the acquiring company's consolidated enterprise and thereby spare the dissolved corporation the costs of continued existence—winding up expenses, litigation costs, and the like. See, e.g., CAL. CORP. CODE § 2010 (West 1990) (describing what corporate duties, such as prosecuting legal actions, survive dissolution).

¹⁴⁵ See CAL. CORP. CODE § 2001(g) (West 1990).

¹⁴⁶ See *id.* Section 2001(g) requires that sales for any consideration other than cash comply with § 1001, which requires shareholder approval of the transaction. The

nia requires a ninety percent supermajority approval of the transaction—a measure aimed at protecting shareholders from insider overreaching.¹⁴⁷

The New York and Illinois provisions governing the board's actions after dissolution are more restrictive than their California counterparts. Although the New York and Illinois statutes contemplate the sale of corporate assets to satisfy creditors and benefit shareholders, these measures do not explicitly provide the flexibility inherent in California's statute. The New York statute seems to require the dissolved company's board to structure the dissolution as an asset sale, rather than as a merger.¹⁴⁸ There is, however, case law interpreting the statute to allow a sale of shareholders' interests, instead of assets.¹⁴⁹ Inasmuch as shareholders' interests in corporations are often most easily disposed of through statutory merger, courts should construe the statute to permit any normal corporate acquisition. In New York, the statutes render it more difficult to accept securities than cash for the corporation's assets.¹⁵⁰

statute is appropriately liberal in granting the board the flexibility to act quickly: the shareholder approval may occur "either before or after approval by the board and before or after the transaction." CAL. CORP. CODE § 1001(a)(2) (West 1990). If the board has carefully auctioned the corporation at the best available price, the shareholders will likely approve the transaction.

¹⁴⁷ Section 2001(g) requires compliance in all instances with § 1001(d) regardless of the form of consideration received. See CAL. CORP. CODE § 2001(g). Section 1001(d) states:

(d) If the buyer in a sale of assets pursuant to subdivision (a) of this section or subdivision (g) of Section 2001 [regulating dissolution-related sales] is in control of or under common control with the seller, the principal terms of the sale must be approved by at least 90 percent of the voting power unless the sale is to a domestic or foreign corporation in consideration of the nonredeemable common shares of the purchasing corporation or its parent.

CAL. CORP. CODE § 1001(d) (West 1990).

In addition to the supermajority requirement governing transactions in which affiliates pay shareholders in other than the affiliate's common stock, California subjects interested transactions to rigorous procedural requirements and strict judicial scrutiny for fairness. See CAL. CORP. CODE § 310 (West 1990); *Remillard Brick Co. v. Remillard-Dandini Co.*, 241 P.2d 66 (Cal. Dist. Ct. App. 1952).

¹⁴⁸ New York authorizes the corporation to "sell its assets," whether for cash as in § 1005(a)(2) or for securities or a combination of securities as in § 1005(a)(3)(A), or to distribute its assets to its shareholders under § 1005(a)(3)(B). See N.Y. BUS. CORP. LAW § 1005(a)(2), (a)(3)(A)-(B) (McKinney 1986). Although the language would not prohibit selling all of the corporation's assets to one bidder, the statute's failure to provide for a sale of the business could invite an interpretation that precludes a disposition by way of statutory merger.

¹⁴⁹ See *In re T.J. Ronan Paint Corp.*, 469 N.Y.S.2d 931, 937 (App. Div. 1983) (directing the public sale of the corporation if the shareholders could not agree to the terms of a private sale).

¹⁵⁰ New York allows the corporation to "sell its assets for cash." N.Y. BUS. CORP.

Like California, New York allows the board to sell the corporation's assets for cash without requiring shareholder approval.¹⁵¹ If the sale is for any consideration other than cash, the corporation must first provide for payment of its liabilities; then shareholders must vote to approve the transaction.¹⁵² New York has no equivalent to California's provision requiring supermajority approval by the shareholders when the buyers are affiliated with the dissolving corporation. Nevertheless, under general provisions of corporate law, the transaction is subject to judicial review if conflicts of interest create the potential for unfairness to the other shareholders.¹⁵³

Illinois does not detail the procedure through which a board may sell a dissolved corporation. The relevant statute limits its discussion to the collection and disposal of corporate assets.¹⁵⁴

LAW § 1005(a)(2) (McKinney 1986). New York also allows the corporation to sell its assets for "shares, bonds, or other securities," but only "[a]fter paying or adequately providing for the payment of its liabilities." *Id.* § 1005(a)(3)(A) (emphasis added). Courts should construe the word "after" broadly to accept the simultaneity of a merger's timing, in which liabilities are assumed at the same instant as assets are transferred. At the moment a merger becomes effective, the disappearing corporation merges (disappears) into the surviving corporation and its assets and liabilities become those of the surviving corporation. *See, e.g.*, § 906(b)(2)-(3). Courts should construe § 1005(a)(3)(A)'s word "after" broadly so that the surviving corporation's assumption of the disappearing corporation's assets and liabilities at the moment of the merger's effectiveness satisfies § 1005(a)(3)(A)'s requirements.

¹⁵¹ *See id.* § 1005(a)(2) (authorizing a corporation, after dissolution, to "wind up its affairs" through various actions, one of which is the sale of assets for cash with no mention of a shareholder vote).

¹⁵² *See id.* § 1005(a)(3)(A) (requiring that a corporation, before it is permitted to sell corporate assets "where the consideration is in whole or in part other than cash," must "pay[] or adequately provid[e] for the payment of its liabilities" and receive authorization for such a sale "by a vote of the holders of a majority of all outstanding shares entitled to vote").

¹⁵³ *See id.* § 713 (detailing the duties and procedures that arise when a corporation contracts or transacts with an interested party). The provisions protect interested transactions from being voided solely because they are interested and specify procedures by which adequate disclosure and disinterested procedure can help sterilize the transaction. In many jurisdictions, however, courts have been willing to scrutinize and undo transactions that comply with procedural requirements if the court finds unfairness. For an example of this phenomenon in California, see *Remillard Brick Co. v. Remillard-Dandini Co.*, 241 P.2d 66, 74 (Cal. Dist. Ct. App. 1952) (stating that courts will "grant appropriate relief" in a transaction between corporations with common directors if the transaction involves "unfair dealing to the detriment of minority stockholders").

¹⁵⁴ Illinois provides that "a dissolved corporation shall not thereafter carry on any business except that necessary to wind up and liquidate its business and affairs, including:

- (1) Collecting its assets;
- (2) Disposing of its assets that will not be distributed in kind to its shareholders

The scope of winding up and liquidating should encompass more than just asset sales. If the highest bidder wants to buy the corporation as a whole and will assume the corporation's liabilities, surely the board may sell the corporation under these conditions, whether through stock purchase or statutory merger.

Structuring the disposition as a statutory merger, as opposed to a sale of assets, would normally benefit all parties involved: by operation of law, the surviving company assumes all of the liabilities of the subject corporation.¹⁵⁵ In addition, mergers typically impose smaller transaction costs than do asset sales.

Once management understands that it must auction the corporation, it should do its best to get the highest price for shareholders. First, the outside directors should conduct the auction. Second, if insiders bid, California's supermajority requirement for sales to insiders and disclosure under the securities laws will pressure boards to make a thorough, disinterested examination of the alternatives. Where appropriate, these directors should use sophisticated investment banking firms, linking their compensation proportionally to the amount of the proceeds, thereby properly aligning their interests with those of shareholders.

2. Possible Improvements

Legislatures should modernize dissolution laws to make clear that when shareholders approve dissolution, the board may use any legal corporate transaction—asset sale, stock sale, or merger—to dispose of the assets, business, and/or stock of the company. Whatever the transaction, management should strive to obtain the

...."

ILL. ANN. STAT. ch. 805, para. 5/12.30 (Smith-Hurd 1993). The statute does not limit what is "necessary to wind up and liquidate [the corporation's] business and affairs," so the business of the corporation could presumably be sold to one purchaser.

¹⁵⁵ Thus, although a merger will not result in the immediate satisfaction of corporate liabilities, the law mandates the ultimate satisfaction of such obligations. *See, e.g.*, DEL. CODE ANN. tit. 8, § 259 (1991) (stating that "all debts, liabilities and duties of the respective constituent corporations shall thenceforth attach to said surviving . . . corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it"); N.Y. BUS. CORP. LAW § 906(b) (McKinney 1986) (providing that, upon the effectiveness of a merger, the surviving corporation "shall assume and be liable for all the liabilities, obligations and penalties of each of the constituent corporations"); RMBCA § 11.06(a) ("When a merger takes effect: . . . (3) the surviving corporation has all liabilities of each corporation party to the merger.").

highest price for shareholders consistent with fully honoring the entitlements of non-shareholders. Further, where necessary, states should clarify that directors conducting the sale may accept, on behalf of shareholders, any form of consideration, including securities of the bidder.¹⁵⁶

The law should prevent insiders from using informational advantages to benefit themselves at other shareholders' expense. Given that managerial inefficiency will have moved shareholders to dissolve the corporation, allowing management any unfair informational advantage during the auction would be singularly inappropriate. The problem, then, is to design a regime that will allow management's participation but discourage opportunism. Here, California's provision requiring supermajority approval of sales to controlling shareholders or their affiliates provides a useful model.¹⁵⁷ Requiring that a supermajority of disinterested stockholders approve insider purchases of all or any substantial portion of the corporation would offset insiders' advantages to some degree and force insiders to bid generously. Alternatively, Delaware case law concerning the auctioning of corporations provides useful rules for a board's disposition of the company.¹⁵⁸

¹⁵⁶ For example, New York should eliminate the bias for cash sales evidenced by N.Y. BUS. CORP. LAW § 1005 (McKinney 1986). See *supra* notes 148, 150 and accompanying text. A better dissolution regime would allow more liberal procedures for the sale transaction.

¹⁵⁷ See *supra* note 147. Note, however, that CAL. CORP. CODE § 1001(d) (West 1990) provides a loophole for insiders. If the affiliate of the company (i.e., an insider) pays the corporation's shareholders with nonredeemable common stock of the purchasing corporation, the 90% requirement does not apply. Implicitly, the insider may then purchase the selling company's assets in the same procedure as may other bidders. Consequently, courts should scrutinize for fairness insider purchases that escape the 90% supermajority vote. See *supra* note 147.

¹⁵⁸ In *Paramount Communications, Inc. v. QVC Network Inc.*, 637 A.2d 34 (Del. 1994), the Delaware court explicitly stated that conducting an auction triggers the same enhanced scrutiny as does using takeover defenses. "The decisions of this Court have clearly established the circumstances where such enhanced scrutiny will be applied. . . . (1) the approval of a transaction resulting in a sale of control, and (2) the adoption of defensive measures in response to a threat to corporate control." *Id.* at 42. Although the *QVC* court did not explicitly state the reason for the enhanced scrutiny, the scrutiny is likely grounded in the concern adduced in *Unocal Corp. v. Mesa Petroleum Co.*: "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders." 493 A.2d 946, 954 (Del. 1985).

The conflict of interest that concerns the court may be management's favoritism toward a preferred bidder over a disfavored bidder or merely management's hostility toward a disfavored bidder. See *QVC*, 637 A.2d at 45 (noting the heightened scrutiny involved when "competing bidders are not treated equally"); *Revlon, Inc. v.*

F. *Would the Law Grant the Board Sufficient Discretion to
Maximize Shareholder Value During Disposition
of the Corporation's Assets?*

1. Current Law

After shareholders vote for dissolution, can the board run the corporation so as to maximize its value to potential purchasers? The disposition of a large public corporation takes time.¹⁵⁹

MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986) (holding that "when bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions"); *see also* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1288 (Del. 1989) (citing same proposition from *Revlon*). The Delaware court's move to extend its vigilance for conflict of interest from the takeover defense context to the sale of control context was a wise one, reflecting the court's appreciation of the target board's antagonism toward unsolicited bidders. The auctions for Revlon, Macmillan, and Paramount demonstrate how favoritism for one bidder and antagonism toward another can distort the auction process to the disadvantage of shareholders.

Shareholder-initiated dissolution may dissipate this antagonism and the disadvantage that accompanies it. Shareholders, in effect, solicit bidders, negating the concept of the "unsolicited bidder" so reviled in boardrooms. If the board does not disfavor one bidder as an interloper and favor another bidder as management's preference, it will probably conduct a more emotionally even-handed auction. Naturally, to the extent that the board acts to advantage one bidder over another, *Macmillan's* strictures are appropriate: the board's favoritism must enhance shareholder interests and "be reasonable in relation to the [shareholder] advantage sought to be achieved." *Macmillan*, 559 A.2d at 1288. When all bidders are on a level auction terrain, the enhanced scrutiny would seem unnecessary, and the court should protect business decisions taken in due care to preserve the company's marketability.

If insiders are bidding, then the strictures of the "entire fairness" standard as articulated in *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983) (stating that when directors of a Delaware corporation are on both sides of a transaction, they must demonstrate utmost good faith and fairness, which in an interested control transaction requires both fair price and fair dealing), and its progeny and the cautionary sections of *Macmillan* and *QVC* provide formal protections against abuse. It should be noted, however, that knowledgeable commentators have indicated doubt that such protections are as effective as the Delaware courts think. *See, e.g.*, VICTOR BRUDNEY & WILLIAM W. BRATTON, *BRUDNEY AND CHIRELSTEIN'S CASES AND MATERIALS ON CORPORATE FINANCE* 786 (4th ed. 1993) (suggesting that the courts' sophistication does not always provide a meaningful remedy).

¹⁵⁹ The auction could be over in a few weeks but more likely would take several months. Brown and Raymond report an average time of approximately two and a half months for contested hostile takeovers between 1980 and 1984. Brown & Raymond, *supra* note 76, at 62. After 1984, takeovers took longer, due to boards' ability to use the poison pill to delay bidders' purchase of shares tendered by shareholders. *See, e.g.*, CRTF Corp. v. Federated Dep't Stores, Inc., 683 F. Supp. 422, 439 (S.D.N.Y. 1988) (validating poison pill as "a shield to fend off coercive offers, and . . . a gavel to run an auction" and crediting it with helping the board extract a higher

Requiring a corporation to suspend entirely its business during the sale would ill serve society. No one would argue in favor of simply shutting down a corporation during the auction process. Yet some dissolution provisions seem to obstruct boards from protecting the corporation's value during its disposition.

Illinois structures the dissolution process so as to provide the board considerable flexibility in maintaining the corporation's value up to the point the articles of dissolution are filed. Under Illinois law, dissolution is effective not at the moment that shareholders approve dissolution but only after articles of dissolution have been filed with and accepted by the Illinois Secretary of State.¹⁶⁰ After the dissolution is effective, however, "a dissolved corporation shall not carry on any business except that necessary to wind up and liquidate its business and affairs."¹⁶¹ Indeed, the statute renders directors "jointly and severally liable to the creditors of [the] corporation for all debts and liabilities" if the directors stray from permissible business activity after filing in connection with dissolution.¹⁶² In one case, a director was held liable for carrying on the

bid); *Reulon*, 506 A.2d at 181 (validating the pill as allowing the board to "protect[] the shareholders from a hostile takeover at a price below the company's intrinsic value, while retaining sufficient flexibility to address any proposal deemed to be in the stockholders' best interests").

Given that dissolution will disarm takeover defenses, transfers of the corporation's assets can occur faster than when sophisticated defenses interfere with bidding. Consequently, the two and a half months that contested takeovers took between 1980 and 1984 is likely a more accurate time frame than is the duration of contested takeovers in the late 1980s or 1990s.

Where management liquidates a company piecemeal, the process tends to be lengthy. Erwin reports average times of 0.66 years from the press date announcing management's intention to liquidate to shareholder approval, *see* Erwin, *supra* note 61, at 96 tbl. 3.1, and 3.44 years from shareholder approval of the plan through the final liquidating distribution of the proceeds, *see id.* at 17, yielding an average of 4.1 years from announcement through final payout, *see id.* at 14. Where firms are auctioned as going concerns, however, the process should take no longer than a hostile takeover in which the board can use defenses only to protect the auction.

¹⁶⁰ Illinois law provides:

(a) When a voluntary dissolution has been authorized as provided by this Act, articles of dissolution shall be executed and filed . . .

(b) When the provisions of this Section have been complied with, the Secretary of State shall issue a certificate of dissolution.

(c) The dissolution is effective on the date of issuance of the certificate thereof by the Secretary of State.

ILL. ANN. STAT. ch. 805, para. 5/12.20 (Smith-Hurd 1993).

¹⁶¹ *Id.* para. 5/12.30(a).

¹⁶² *Id.* para. 5/8.65(a)(3).

For a case demonstrating the sweep of liability for carrying on business after

corporation's business after dissolution notwithstanding the corporation's subsequent reinstatement and irrespective of whether the reinstated corporation ratified actions the director took on its behalf.¹⁶³

Like Illinois, New York provides considerable flexibility in maintaining the corporation's value by deeming the corporation to be dissolved only upon the filing of the certificate of dissolution with the New York Department of State, not at the time of the shareholder's approval of the dissolution vote.¹⁶⁴ New York case law restricts directors' ability after dissolution to maintain the value of the corporation by continuing ordinary business.¹⁶⁵ In a recent case, the court held agents of dissolved corporations personally liable for entering into transactions—unrelated to winding up—on behalf of the corporation.¹⁶⁶ The law, therefore, should enable directors to delay delivering the certificate of dissolution so long as they move expeditiously toward a sale of the company.

As to timing, courts should give considerable latitude to boards involved in good faith negotiation to auction the corporation. Current law provides ample time.¹⁶⁷ Under New York law, courts

filing the articles of dissolution, albeit respecting an officer rather than a director, see *Steve's Equip. Serv., Inc. v. Riebrandt*, 459 N.E.2d 21, 24 (Ill. App. Ct. 1984) (holding that officers are personally liable for contracts entered into after dissolution if they "knew, or because of their position should have known, of the dissolution").

¹⁶³ See *Chicago Title & Trust Co. v. Brooklyn Bagel Boys, Inc.*, 584 N.E.2d 142, 146 (Ill. App. Ct. 1991) (noting that Illinois law, while allowing reinstated companies to ratify earlier actions, "does not transform individual liability into corporate liability").

¹⁶⁴ See N.Y. BUS. CORP. LAW §§ 1003-1004 (McKinney 1986); see also *Beveridge & Lewis*, *supra* note 94, at 200 (listing the conditions that a New York corporation must meet before officially dissolving).

¹⁶⁵ See, e.g., *Lorisa Capital Corp. v. Gallo*, 119 A.D.2d 99, 114 (N.Y. App. Div. 1986) (barring a corporation that had been dissolved for failing to pay franchise taxes from suing until it paid its back taxes and reinstated its corporate existence). *But cf.* *Igbara Realty Corp. v. New York Property Ins. Underwriting Ass'n*, 94 A.D.2d 79, 80 (N.Y. App. Div. 1983), *modified*, 470 N.E.2d 858 (N.Y. 1984) (reversing trial court that had dismissed dissolved corporation's suit against insurer for reimbursement for fire damage because the insurance policy was issued after dissolution and holding that winding up corporation included taking care of its property until winding up was completed).

¹⁶⁶ See *WHITE ON CORPORATIONS*, *supra* note 104, ¶ 1005.02; see also *Brandes Meat Corp. v. Cromer*, 146 A.D.2d 666, 667 (N.Y. App. Div. 1989) (holding that purchases made by defendant on behalf of corporation dissolved more than three years earlier were unconnected with winding up the business and thus created personal liability for defendant). The dilatory fashion in which the agents wound up the company probably triggered the court's seemingly harsh judgment.

¹⁶⁷ One could argue that the law gives boards too much time to negotiate auctions.

can appoint receivers to oversee a dissolution, and, within one year of qualifying, such receivers may settle accounts.¹⁶⁸ New York case law suggests that certain circumstances may permit even longer time frames.¹⁶⁹ Thus, boards should have enough time to maximize returns to shareholders, but not so much time as to jeopardize the dissolution process itself.

Under California law, shareholders' adoption of a resolution electing to dissolve the corporation, rather than a filing of a final certificate of merger, changes the legal rights of the corporation to carry on regular business.¹⁷⁰ In the absence of any exception, California law would force all ordinary business to halt upon shareholders' approving dissolution. California, however, grants the dissolving corporation's board of directors considerable discretion by allowing directors to take actions to preserve the corporation's going-concern value pending the sale of the company.¹⁷¹ Thus,

Courts will need to oversee management's progress in selling the corporation. To the extent that management drags out the process, it increases costs and lowers returns of arbitrageurs. Given that dissolution depends largely on arbitrageurs to bid up the company's stock price in anticipation of a dissolution vote, allowing the board to stall the auction will distort market signals about dissolution's desirability.

¹⁶⁸ See N.Y. BUS. CORP. LAW § 1216(a) (McKinney 1986). The one-year period can be extended by the attorney-general. See *id.* After 18 months, the attorney-general is obligated to apply for an order that the receiver show cause why a final settlement should not be made. See *id.*

¹⁶⁹ See *In re T.J. Ronan Paint Corp.*, 98 A.D.2d 413, 420-21 (N.Y. App. Div. 1984) (holding that "[t]he pendency of this [involuntary dissolution] proceeding for more than three years is far in excess of the time reasonably required to effect a final dissolution, even allowing for the animosity and hostility which have plagued the proceeding").

¹⁷⁰ California law provides:

(a) Voluntary proceedings for winding up the corporation commence upon the adoption of the resolution of shareholders or directors of the corporation electing to wind up and dissolve, or upon the filing with the corporation of a written consent of shareholders thereto

. . . .

(c) When a voluntary proceeding for the winding up has commenced, the corporation shall cease to carry on business except to the extent necessary for the beneficial winding up thereof and except during such period as the board may deem necessary to preserve the corporation's goodwill or going-concern value pending a sale of its business or assets or both, in whole or in part.

CAL. CORP. CODE § 1903(a), (c) (West 1990).

¹⁷¹ Section 1903(c) provides:

[T]he corporation shall cease to carry on business except to the extent necessary for the beneficial winding up thereof *and except during such period as the board may deem necessary to preserve the corporation's goodwill or going-concern value pending a sale of its business or assets, or both, in whole or in*

California arguably would allow the board to continue to engage in ordinary positive net present value transactions during the disposition, thereby enhancing the benefit to shareholders.

2. Possible Improvements

Dissolution law should charge directors with preserving the going-concern value of the corporation's business. The law should permit the board, where appropriate, to undertake reasonable transactions not connected with winding up the affairs of the corporation so as to maximize its attractiveness for bidders. Directors running the auction should have the protection of the business judgment rule, consistent with *Revlon*¹⁷² and its progeny.¹⁷³

G. *Can Poison Pills or State Anti-Takeover Statutes Stop Shareholders from Calling for a Dissolution Vote?*

1. Current Law

If shareholders vote to dissolve the corporation, they effectively put the corporation into the *Revlon* mode.¹⁷⁴ At that point, poison pills cease to act as legitimate defensive mechanisms and can function only as a shield and a gavel to conduct a value-maximizing

part.

Id. § 1903(c) (emphasis added).

¹⁷² *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

¹⁷³ See *Paramount Communications, Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 (Del. 1994) (granting the board significant latitude in conducting an auction, but mandating enhanced judicial review of transactions effecting sales or changes of control in the target, which review focuses on the adequacy of the board's decisionmaking process and the reasonableness of the directors' action given then existing circumstances); *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1288 (Del. 1989) (granting the board significant latitude in structuring an auction, including the ability to treat bidders disparately, but requiring that if the board treats bidders disparately, it must show that the disparate treatment enhances shareholders' interests and that "the board's action must be reasonable in relation to the advantage sought to be achieved, or conversely, to the threat which a particular bid allegedly poses to stockholder interests").

¹⁷⁴ See *Revlon*, 506 A.2d at 182 (holding that when the break-up or sale of a corporation becomes inevitable, the board's duty changes "from the preservation of [the company] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit"); *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989) (holding that *Revlon* duties are triggered if the "dissolution or break-up of the corporate entity [becomes] inevitable").

auction.¹⁷⁵ Similarly, because state legislatures were not so obtuse as to draft state anti-takeover laws to interfere with friendly acquisitions, by forcing an auction of the corporation, shareholder-initiated dissolution forces the board to treat the winning bid in the same way it would treat a friendly bid and to suspend the potential operation of state anti-takeover laws. Consequently, in conducting the auction, management would have to approve the winning bid and could not use the statute to prevent a disfavored bidder from winning.

Could anti-takeover defenses, however, stop shareholders from *initiating a vote* on dissolution? Would a call for dissolution trigger the poison pill or other defenses? If so, shareholders could no more afford to bring dissolution to a vote than unsolicited bidders could afford to purchase shares tendered to them and thereby trigger the poison pill.

a. *Poison Pills*

In the mid-1980s, poison pills, formally called shareholders' rights plans, effectively removed target shareholders' ability to sell their shares to a bidder without incumbent management's approval. These plans provided, in form, for the distribution to target corporation shareholders of rights comparable to complex warrants that allow the holder to buy various securities, depending on the circumstances, the sole purpose of which rights was to make purchasing target corporation stock without board approval prohibitively expensive.¹⁷⁶

¹⁷⁵ See *supra* note 159.

¹⁷⁶ In the earlier, "flip-over" variant, if the bidder engages in a combination with the target, whether by merger or sale of assets, the "rights" are transformed and thereafter obligate the target corporation (now under the bidder's control) to make effective provision so that each holder of a right can purchase a specified, significant dollar amount of the *bidder's* stock at half price. Thus, the bidder cannot afford to carry out the merger or purchase of target assets, because the rights would entitle the remaining target company shareholders to dilute disastrously the percentage shareholdings of the bidder's original shareholders.

Similarly, in the later-created "flip-in" variant, if the bidder acquires "beneficial ownership" of a specified, relatively low percentage of the target's stock, each right is transformed into the right to purchase the target's stock at half price. The bidder, however, is excluded from the discount purchase. Rights plans, however, permit the board to redeem the rights as applying to any bidder it favors, even while retaining them against the disfavored bidder. For summary explanation of the poison pill, see, e.g., 3 MARTIN LIPTON & ERICA H. STEINBERGER, TAKEOVERS AND FREEZEOUTS § 6.03[4], at 6-57 to 6-69 (1995); for the form of a typical Share Purchase Rights Plan (the poison pill agreement) itself, see *id.* at H-16 to H-95, especially H-19 to H-22

In the face of the poison pill, a bidder typically could not afford to purchase shares of the target corporation's stock without board approval, even if virtually all of the shares had been tendered by the target shareholders. Thus, even when bidders offered generous premiums that shareholders overwhelmingly desired, management, acting alone and clearly against shareholders' wishes, could prohibit shareholders from selling their stock to the bidder by refusing to redeem the pill.¹⁷⁷

Currently, takeover defense specialists have made shareholder action even more risky by employing the SEC 13(d) rules' over-expansive definition of "beneficial ownership" to define when a shareholder has accumulated enough stock to trigger the poison pill.¹⁷⁸ The risk for dissolution proponents is that any communications they have with one another may inadvertently trigger the pill or trigger harassing litigation by management. If poison pills can prevent shareholders from calling a vote on dissolution, they can prevent shareholder-initiated dissolution.

In a string of important cases, Delaware courts, although permitting significant infringement on shareholders' ability to challenge management, have made clear that management may not use a poison pill to frustrate shareholders from calling a vote.¹⁷⁹

(flip-in provisions) and H-51 to H-54 (flip-over provisions).

¹⁷⁷ Thus, although holders of 93% of Interco's shares and of 87% of Pillsbury's shares (including over 50% of employee-held shares) wished to sell their shares to the bidder, only when the Chancery Court forced the targets' boards to redeem the pill, did the boards do so. See *supra* note 25; see also *Grand Metro. Pub. Ltd. v. Pillsbury Co.*, 558 A.2d 1049, 1058 (Del. Ch. 1988) (noting that Pillsbury employees had caused over 50% of the Pillsbury stock held by a trustee of the Pillsbury Employees Benefit Plans to be tendered to the bidder).

¹⁷⁸ See *infra* notes 198-204 and accompanying text. For the SEC's definition of "beneficial ownership," see Rule 13d-3 (defining beneficial ownership as possession of voting and/or investment power enjoyed directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise). See 17 C.F.R. § 240.13d-3 (1995). For discussion of this Rule, see 5 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 2183-87 (1990).

¹⁷⁹ In *Stahl v. Apple Bancorp, Inc.*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,412 (Del. Ch. Aug. 9, 1990), the Court noted that Rights Plans normally are drafted so that the poison pill is not triggered by any agreement, arrangement, or understanding to vote the company's securities that "arises solely from a revocable proxy or consent given in response to a public proxy or consent solicitation." *Id.* ¶ 95,412, at 97,033. The *Stahl* court also interpreted *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985) as effectively exempting from the language of rights plans revocable proxies where counting such proxies for purposes of triggering the pill would materially interfere with conducting a proxy contest. See *id.* ¶ 95,412, at 97,036.

Stroud v. Grace, 606 A.2d 75 (Del. 1992), affirmed that where a board employs

Other jurisdictions would presumably follow Delaware in not allowing shareholders to be disenfranchised. As described more fully below, the safest procedure is for one proponent to initiate the call for a dissolution vote by using SEC Rule 14a-1(l)(2)(iv), which allows the proponent to publish its views on a matter on which stockholders will vote.¹⁸⁰

b. *State Anti-Takeover Statutes*

Currently, a wide variety of state anti-takeover statutes exist, but only the control share acquisition statutes pose any threat to getting dissolution on the ballot.¹⁸¹ Control share acquisition statutes

"various legal strategies either to frustrate or completely disenfranchise a shareholder vote . . . [t]here can be no dispute that such conduct violates Delaware law." *Id.* at 91. Although *Stroud* allowed the corporation to adopt provisions that made it difficult for a minority shareholder to have a realistic chance at gaining a seat on the board, nothing in the opinion would allow a board to preclude shareholders from voting for a dissolution.

In re Chrysler Corp. Shareholders Litigation, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,996 (Del. Ch. July 27, 1992), confronted a defendant corporation's lowering of its poison pill's "flip-in" trigger from 30% to 20%, and then to 10%, in the face of an investor taking a 9.8% position in the company's stock. The court refused to dismiss the plaintiffs' complaint that reducing the trigger to 10% diminished their ability to receive hostile takeover proposals or engage in proxy fights, finding that the facts and allegations created a "reasonable doubt that the directors were motivated solely or primarily by entrenchment concerns." *Id.* ¶ 96,996, at 94,350.

Although such decisions have allowed directors considerable latitude in obstructing dissidents' electioneering, they strongly suggest that shareholders should be able to invalidate any poison pill that precludes shareholders from calling for a dissolution vote.

¹⁸⁰ See *infra* notes 212-16 and accompanying text. In brief, the initiating shareholder can publicize its intent to present its shares, demanding a vote on dissolution on a specified date; other dissatisfied large shareholders should follow suit and show up at the same time and present their shares with the same demand. By calling for a meeting independently of one another but with enough aggregate shares to cross the required threshold, large shareholders can put the dissolution vote on the ballot without forming a group and triggering poison pills.

¹⁸¹ For a description of the variety of statutes, see John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425, 1440-52 (1991). The business combination statutes block business combinations between the company and the bidder. See *id.* at 1440. Fair price statutes prohibit takeovers, unless disinterested shareholders approve the bidder's offer and the offer provides shareholders in the second-stage squeeze-out merger consideration worth as much as that paid to shareholders who tendered their shares in the tender offer. See *id.* at 1445-47. Disclosure statutes require extra information from any would-be acquiror. See *id.* at 1447-48. Non-shareholder constituency statutes allow directors to consider non-shareholder interests when assessing a takeover offer. See *id.* at 1448-50. Shareholder rights plan endorsement

typically remove voting power from the stock of bidders who acquire certain levels of share ownership (usually twenty percent, thirty-three and one-third percent, and fifty percent), subject to restoration of voting power by disinterested shareholder vote.¹⁸² Although aggregating shares for purposes of exercising voting rights, including calling for a dissolution vote, would appear to fall outside the scope of these statutes, control share acquisition statutes have already chilled discussions among institutional investors, who have worried that having such discussions would cause them to be deemed a group holding more than twenty percent and would thus result in a loss of voting power.¹⁸³ So to curtail shareholders' voting rights would be to expropriate shareholders on behalf of management; but such an interpretation is not beyond imagination.¹⁸⁴ Consequently, as with the procedure to avoid triggering poison pills, a proponent wishing to call for a dissolution vote should use SEC Rule 14a-1(l)(2)(iv)'s safe harbor to announce its intention to present its shares in demand of a vote on dissolution, thereby assuring that its shares will not be aggregated with others'

statutes expressly authorize poison pills that discriminate against the bidder. *See id.* at 1450. Anti-greenmail statutes generally prohibit repurchases of the bidder's stock at higher than fair market value. *See id.* at 1450-51. Cashout statutes, in effect, give minority holdouts appraisal rights and force the bidder to consummate the takeover at a judicially imposed price. *See id.* at 1451-52. Although these provisions would impede or block a bidder's unsolicited acquisition, they do not address dissolution and do nothing to interfere with shareholders' ability to call for a dissolution vote.

¹⁸² *See id.* at 1442-44 (describing a prototypical control share acquisition statute, which prohibits the acquiror of 20% or more of a target's shares from voting those shares unless a majority of disinterested shareholders grant the acquiror voting rights).

¹⁸³ *See, e.g.,* Grundfest, *supra* note 2, at 863 n.18 (citing cases in which courts have invalidated proxies as violating state control shares acts, and noting the chilling effect of state anti-takeover laws on the exercise of the corporate franchise). During the struggle over whether shareholders would approve a sale of Centel Cellular Corp. to Sprint Corp., large shareholders were surprised to find that Kansas's control share anti-takeover statute made it risky to form groups to oppose the merger. *See* Anthony Ramirez, *Growing Revolt of Centel Holders*, N.Y. TIMES, July 14, 1992, at D8 (citing Kansas provisions, for example, that allow management to force a special shareholders meeting to consider the "voting rights to be accorded" to dissident shareholders). Kansas officials expressed similar surprise. When informed of large shareholders' concerns about Kansas's law, the general counsel for the Kansas Securities Commission expostulated correctly, "My God, that would be antithetical to corporate democracy." *Id.*

¹⁸⁴ Stephen Bainbridge has argued that state anti-takeover laws could be used to disable dissidents not just from conducting takeovers but also from conducting successful proxy fights, consistent with accepted readings of the reach of the Williams Act. *See* Stephen M. Bainbridge, *Redirecting State Takeover Laws at Proxy Contests*, 1992 WIS. L. REV. 1071.

shares to reach the twenty-percent threshold.

2. Possible Improvements

Corporate law's legitimacy rests upon shareholders' ability to confer with other shareholders and to call for votes as well as to vote their own shares whenever shareholders have the right to do so. States should make clear that poison pills and state anti-takeover statutes may not interfere or threaten to interfere with shareholders' ability to call for votes and to vote.

V. HOW WOULD DISSOLUTION WORK UNDER FEDERAL SECURITIES LAWS?

A. *The Obstacles*

Until recently, commentators have tended to view state corporation laws as frequently damaging shareholders' welfare and federal securities laws as offering shareholders beneficial protection.¹⁸⁵ With the new attempts to design more effective governance structures, commentators have come to recognize the extent to which federal securities laws, especially the Securities Exchange Act of 1934 (the "34 Act"),¹⁸⁶ regardless of their original intention,¹⁸⁷ work to the advantage of management and to the disadvantage of dissident shareholders.¹⁸⁸ In states that allow dissolution, in fact,

¹⁸⁵ The clearest claims of the relative superiority of federal securities laws vis-à-vis state corporation laws have tracked the debate over federalizing corporate law (pro tanto supplanting state law). For useful descriptions of the debate, see ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 14-31 (1993) (noting, among other things, that the view that state corporate law represented the result of "a race for the bottom" and that federal intervention was necessary to regulate corporations constituted "for many years, the consensus view of commentators on corporate law"); Bratton & McCahery, *supra* note 35, at 1876-83 (describing the intellectual struggle over the desirability of federal intervention into state corporate law).

¹⁸⁶ 15 U.S.C. § 78a-78ll (1994).

¹⁸⁷ For an abbreviated history of the evolution of the SEC's minimal restraints on intrashareholder communications in 1935 to the current burdensome regulations, see John Pound, *Proxy Voting and the SEC: Investor Protection Versus Market Efficiency*, 29 J. FIN. ECON. 241, 253-68 (1991); see also Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1132-33 (1993) (noting that Congress originally wished to protect shareholders from insider practices that limited effectiveness of shareholder voting); Roe, *A Political Theory*, *supra* note 30, at 46 (noting the SEC's responsiveness to managers' desire to impede proxy contests in the 1950s).

¹⁸⁸ See Pound, *supra* note 187, at 267, 279-80 (describing how current concentrated ownership by institutional investors and advances in communications technology

the '34 Act creates greater obstacles for shareholders to exercise their rights than do state laws. The primary obstacles that the '34 Act presents for shareholders wishing to exercise their state-created right voluntarily to dissolve their corporation include: (a) rules under section 14(a) of the '34 Act governing proxy solicitations, (b) rules under section 13(d) of the '34 Act requiring any person or group owning over five percent of the company's stock to file a Schedule 13D, and (c) requirements of section 16(b) of the '34 Act forcing beneficial owners of more than ten percent of the company's stock, among others, to disgorge profits made in purchases and sales within any six-month period in the company's stock.

1. Section 14(a)'s Proxy Disclosure Requirements

Section 14(a) creates complex requirements governing proxy solicitations in public corporations.¹⁸⁹ As part of these requirements, the SEC has required fastidious disclosure about dissolution since at least 1937.¹⁹⁰ Yet, in the voluntary dissolution described here, it is not clear that disclosure will be at all useful. If proponents believe that an auction may well benefit them, they will want to trigger a shareholder vote on whether to dissolve the corporation. At this point, their sole concern may be to get dissolution on the ballot.

The best information on whether dissolution is advisable will emerge from market reactions, not from claims of either dissidents or managers. If a bid emerges, arbitrage will work to provide market participants' valuation of the bid and of the likelihood that shareholders will vote to dissolve. In the absence of a bid or significant price movement, shareholders must decide something

promise to solve collective action problems but are retarded in doing so by restrictive proxy regulations, which, ironically, were motivated by earlier congressional desire to ameliorate collective action problems).

¹⁸⁹ Section 14(a) requires public corporations fully and truthfully to disclose information concerning matters on which shareholders vote. Public corporations must file this information with the SEC and disseminate it to all shareholders. For general descriptions of the proxy requirements, see 4 LOSS & SELIGMAN, *supra* note 178, at 1916-2119; HAROLD S. BLOOMENTHAL & HOLME ROBERTS & OWEN, SECURITIES LAW HANDBOOK 963-86 (1995).

¹⁹⁰ See Pound, *supra* note 187, at 254 (describing the 1937 SEC staff's activism in finding that a corporation's management failed to provide sufficient information in connection with its recommendation for voluntary dissolution to shareholders, thereby "creat[ing] demand for further regulation").

that inherently involves an unknowable future. Therefore, once the proponent has put dissolution on the ballot, she may well have finished her role in the election.¹⁹¹ What, after all, can she say? She can only state her view that shareholders likely will gain more by auctioning the corporation than by letting current management continue to run it.¹⁹² Given the likelihood that management will litigate over any positive claims for gains from dissolution, shareholders averse to litigation or negative publicity may wish to remain silent.¹⁹³

Additionally, the proponent may desire not to provide specific information because she may intend to rely, along with other shareholders, on the market's reaction to the fact of the upcoming vote on dissolution to convey information about market professionals' estimate of S's value at auction.¹⁹⁴ Especially where no bidder has surfaced, the information conveyed is reciprocal in

¹⁹¹ Because management's proxy card will present shareholders with the choice of voting for dissolution, against dissolution, or of abstaining from the vote, shareholders will be able to vote for dissolution using management's proxy card. Proponents of dissolution therefore have no need to solicit proxies, a point which should press for shareholder communications regarding dissolution not to be deemed "solicitations."

¹⁹² The SEC's demanding requirements for dissolution-related disclosure may also counsel for silence. In 1980, the SEC revised its rules governing projections and forecasts. See Pound, *supra* note 187, at 268. Professor Pound regards the 1980 disclosure changes as the most critical for constraining dissidents. In particular, the 1980 changes require proponents of liquidation to use projections of distribution value only when made "in good faith and on a reasonable basis." This requirement creates disincentives for dissidents to present active, forward-looking analyses, since proponents could always be sued. See *id.*; see also Dennis J. Block & Jonathan M. Hoff, *Forward-Looking Statements: Reducing Litigation Risks*, N.Y. L.J., Aug. 25, 1994, at 5, 6 (stating that "criteria, such as the 'reasonable basis' and 'good faith' standards . . . can be interpreted by a court to require further discovery or adjudication" by the trier of fact). Courts have made clear, however, that corporate projections about the results of future restructurings that are not worded as guarantees are not actionable under the securities laws. See *Krim v. BancTexas Group, Inc.*, [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,451, at 96,527 (5th Cir. May 12, 1993) ("Issuers are not guarantors of the investments they sell."). Similarly, any good faith statement of surmise by a dissolution proponent should not be actionable.

¹⁹³ Naturally, when dissolution is first used, proponents who are not afraid of litigation can help educate other shareholders by explaining how share price movements signal the advisability of voting for dissolution. After a few dissolution-initiated auctions, however, disclosure in favor of dissolving will probably cease to be necessary, replaced instead by market signals and more or less balanced commentary from the financial press.

¹⁹⁴ The market could, of course, signal its doubt that shareholders will adopt the vote for dissolution. This ability to provide unbiased information benefits the potential proponent, as well as other shareholders, signaling that she need spend no time or resources on a dissolution vote.

character: shareholders must approve dissolution before an auction is possible; but before they vote, shareholders want to know if dissolving the corporation will call forth a bidder. The most relevant information is the corporation's stock price as an indicator of *buyers'* estimates of the value of the corporation, whether in an auction or under current management. At most, a proponent could venture opinions about the implications of stock price movements.

In the name of disclosure, however, the '34 Act's proxy rules threaten to place a significant burden on any dissolution proponents, even if the proponents only want to call for a vote and not campaign for dissolution. If efforts to put dissolution on the ballot result in a proxy solicitation, two daunting prospects face the proponents. First, unless they can get an exemption, they must prepare, file, and preclear their "proxy materials" with the SEC—a process which involves considerable time and expense. Second, no matter how accurate the proxy materials, management will likely sue anyone proposing dissolution,¹⁹⁵ claiming misleading or inadequate disclosure. The suit buys management time,¹⁹⁶ casts doubts on the proponent's integrity and intentions, and potentially raises problems for the proponent if it is an institutional investor that has sensitive relationships with other corporations or is a public pension fund that has to navigate tricky political currents.¹⁹⁷ In the longer term, such litigation, when consistently expected, decreases the value to proponents by the amount of their litigation costs and reduces their *ex ante* incentives to propose the dissolution. Thus, management's ability to sue may discourage proponents from defending dissolution. Nevertheless, when arbitrageurs or institutional investors consider the benefits of dissolution-triggered auctions for numerous corporations in their portfolios, they may

¹⁹⁵ See Pound, *supra* note 187, at 272-73, 282 (describing how proxy regulations increase the probability of tactical lawsuits by management against proxy dissidents, thereby deterring proxy initiatives).

¹⁹⁶ See 1 LIPTON & STEINBERGER, *supra* note 176, § 6.06[1], at 6-144 (noting that "the ultimate disposition of these proceedings is often of less immediate concern than the tactical advantage to be gained from timely action to slow down the raider and 'chill' arbitrage activity in the target's stock"); Mark P. Chernow & Sandra F. Coppola, *Use of Litigation As a Takeover Defense*, in 1 NEW DIMENSIONS IN SECURITIES LITIGATION: PLANNING AND STRATEGIES 371 (ALI-ABA Course of Study ed., 1990); Herbert M. Wachtell, *Special Tender Offer Litigation Tactics*, 32 BUS. LAW. 1433 (1977) (acknowledging that one of the primary motivations of litigation is delay).

¹⁹⁷ See Roe, *supra* note 30, at 327 (noting that, as professionals in the securities industry, institutional investors want to avoid news stories such as "XYZ Mutual Fund Sued for Securities Law Violations").

well decide that answering management's criticisms of dissolution is worthwhile.

2. Section 13(d) Requirements

The second obstacle flows from the '34 Act's section 13(d). Section 13(d) requires any person or group acting together that acquires beneficial ownership of more than five percent of a class of equity securities to file a disclosure statement with the SEC within ten days of such acquisition.¹⁹⁸ To bring dissolution to a vote, arbitrageurs or institutional investors must make a demand and, under the regime proposed in this Article, must own more than ten percent of the subject company's shares.¹⁹⁹ If shareholders making such a demand for a dissolution vote are deemed a "person" who has acquired beneficial ownership of the securities for purposes of section 13(d), they must file the Schedule 13D.²⁰⁰ Filing a Schedule 13D imposes unjustified costs and exposes the institutions to strategic litigation by management.²⁰¹

SEC 13(d) rules should not, as a policy matter, sweep in institutions' informal discussions about governance issues.²⁰²

¹⁹⁸ See 15 U.S.C. § 78m(d)(1) (1994).

¹⁹⁹ See *supra* part IV.B.2.

²⁰⁰ The '34 Act specifies that when two or more persons form a group "for the purpose of acquiring, holding, or disposing of securities of an issuer," that group is deemed a "person" for purposes of § 13(d). See 15 U.S.C. § 78m(d)(3) (1994). By hypothesis, the dissolution proponents are not interested in "acquiring, holding, or disposing" of the corporation's securities; they only wish to put dissolution to a vote. Therefore, they would seem to fall outside the purview of the Williams Act.

The SEC, however, has expanded Congress's sweep of what triggers § 13(d) requirements beyond what Congress intended and has included an agreement for voting securities in the list of activities that constitute "beneficial ownership" for purposes of defining when a § 13(d) "group" has been formed. See Rule 13d-5(b)(1), 17 C.F.R. § 240.13d-5(b)(1) (1994). Since any discussions bearing on dissolution can be argued to implicate voting, if only as a background issue, proponents of dissolution must worry that management may sue them as constituting a "group" for purposes of the 13(d) rules unless they file the Schedule 13D.

²⁰¹ In the absence of egregious action, such as amassing shareholdings sufficient to block other shareholders' action, the only real threats are those of embarrassment and the litigation costs themselves. First, there is no reason to think that a court will find any actionable misdisclosure. Courts that do find unintentional misdisclosure typically force corrective disclosure. See *Cherno & Coppola, supra* note 196, at 394-95 (noting cases in which bidders were allowed to correct measures by curative disclosure). Courts have imposed broader remedies, such as divestiture, rescission, or having one's voting power sterilized, only where there are egregious and sustained violations. See *id.* at 396-99 (listing cases in which courts granted various forms of injunctive relief).

²⁰² For similar criticisms of the overbreadth of the SEC's definition of what

Proponents of dissolution will likely have no relationship among themselves other than calling for a shareholder vote and will likely not intend to increase their share ownership, stage a takeover or a proxy fight, replace current management, or solicit proxies to do any of these things or, indeed, even solicit proxies to vote to dissolve the corporation. In most instances, they will simply wish to initiate a vote, not to lobby for one position or another. Yet, owing to the SEC's overbroad definition of "beneficial ownership" for purposes of section 13(d),²⁰³ proponents who join forces to call for a dissolution vote cannot know whether they must (and consequently may feel obliged to) file a Schedule 13D. If they care more about negative publicity than about the economic well-being of their beneficiaries, they may simply leave their beneficiaries with a lower return, rather than risk litigation. Worse still, the SEC has aggravated the overbreadth of its definition, for purposes of section 13(d), of "beneficial ownership" by applying this definition to section 16(b),²⁰⁴ thereby threatening proponents with economic damage to their beneficiaries, as well as reputational harm to themselves.

constitutes a group for purposes of the 13(d) rules, see Bernard S. Black, *Next Steps in Corporate Governance Reform: 13(d) Rules and Control-Person Liability*, in MODERNIZING U.S. SECURITIES REGULATIONS: ECONOMIC AND LEGAL PERSPECTIVES 225 (Kenneth Lehn & Robert W. Kamphuis, Jr. eds., 1992) (suggesting specific deregulatory steps that the SEC should consider to encourage shareholder oversight of large public company managers); Black, *supra* note 30, at 542-45 (suggesting that the 13(d) rules are burdensome to institutional shareholders); John C. Coffee, Jr., *Proxy Contests: The Shape of the Future*, N.Y. L.J., Oct. 1, 1992, at 5 (noting that the 13(d) rules are ambiguous and its application uncertain); Conard, *supra* note 26, at 162 (noting that while provisions of the subsection "may be appropriate for takeover bidders, . . . they are grossly excessive for voting coalitions"); Gilson & Kraakman, *supra* note 26, at 896-901 (criticizing the 13(d) rules for their application to concerted action by institutional investors).

²⁰³ See *supra* note 200. Commentators have noted the pro-management, anti-shareholder bias of the SEC's construction. See Black, *supra* note 26, at 542-45; John C. Coffee, Jr., *SEC 'Overregulation' of Proxy Contests*, N.Y. L.J., Jan. 31, 1991, at 7; Gilson & Kraakman, *supra* note 26, at 896-901. The SEC seems to have no plans to review this state of affairs, and legal challenges to the rule as unauthorized by the statute have so far been ineffectual. See, e.g., *Jacobs v. Pabst Brewing Co.*, 549 F. Supp. 1050, 1063-64 (D. Del. 1982) (adopting, in a case minutely inspecting the existence of a private right of action under § 13(d), the strictures of the SEC 13(d) rules without any question as to the SEC's authority to promulgate the rules).

²⁰⁴ See *infra* note 208.

3. Section 16(b)'s Disgorgement Provisions

The third and most draconian securities law obstacle facing dissolution proponents flows from the '34 Act's section 16(b). Designed to preclude insiders' use of inside information, section 16(b) provides that directors, officers, and ten-percent shareholders of a public corporation must disgorge any "profits" made on "short-swing" purchases and sales of the corporation's securities within any six-month period.²⁰⁵ If these matching transactions occur more than six months apart, however, the insider is not liable under section 16(b), even if she traded on inside information.²⁰⁶

Section 16(b)'s threat to dissolution proponents is that, as a "group" owning more than ten percent of S's common stock, they might have to disgorge all "profits" from purchases and sales within any six-month period during which the group exists. Because the SEC applies Rule 13d-5(b)(1)'s overbroad definition of "beneficial ownership"²⁰⁷ to section 16(b),²⁰⁸ if proponents owning more than ten percent of the shares have to file a Schedule 13D, they will also incur liability for any short swing profits.

Dissolution proponents will possess no inside information,²⁰⁹

²⁰⁵ See 15 U.S.C. § 78p(b) (1994). Under § 16(b), if the 10% shareholder purchases shares of the corporation's stock at, say, \$50 per share and sells at \$60 per share within six months of the purchase (or, indeed, sells at \$60 and then buys at \$50 within six months of the sale), she must give back \$10 per share in "profit," irrespective of whether she made a genuine economic profit or whether she traded on inside information.

"Profits," for purposes of § 16(b), are computed so as "to squeeze all possible profits out of stock transactions" using the rule of "lowest price in, highest price out." *Smolowe v. Delendo Corp.*, 136 F.2d 231, 239 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943). For the most famous example of the draconian character of the statute's "mechanical" provisions, see *Adler v. Klawans*, 267 F.2d 840, 847-48 (2d Cir. 1959) (referring to a defendant liable on a \$300,000 § 16(b) "profit" on trades on which he actually suffered real economic losses of \$400,000 (citing *Gratz v. Claughton*, 187 F.2d 46 (2d Cir.), *cert. denied*, 341 U.S. 920 (1951))).

²⁰⁶ She could be sued under § 10(b) and Rule 10b-5, but not under § 16(b).

²⁰⁷ See *supra* note 200 and accompanying text.

²⁰⁸ Rule 16a-1(a)(1) states:

Solely for purposes of determining whether a person is a beneficial owner of more than ten percent of any class of equity securities registered pursuant to section 12 of the Act, the term "beneficial owner" shall mean any person who is deemed a beneficial owner pursuant to section 13(d) of the Act and the rules thereunder

17 C.F.R. § 240.16a-1(a)(1) (1995).

²⁰⁹ One might argue that credible nonpublic information about calling a dissolution vote should count as inside information. The proper analogy, however, is to the information that a bidder has about its own tender offer; typically, such information

yet still might bear liability. They will only *call for* a vote on dissolution. Dissolution will not occur unless a majority of the company's shareholders vote for it. If dissolution receives the requisite approval and the board disposes of the corporation at a premium, all shareholders will benefit pro rata. The communications about proposing a dissolution vote, thus, threaten no harm that Congress meant to regulate under section 16(b).

From the point of view of section 16(b), however, the shareholders who initiated the shareholder-benefiting vote may well have to disgorge profits (as defined by section 16(b)) made after forming the "group" to initiate dissolution. The SEC has not made the status of intrashareholder communication under section 16(b) sufficiently clear to free shareholders from fear that discussions among themselves might cost them disgorgement.²¹⁰ Fortunately, the mechanically draconian results of this statutory provision can be avoided by equally mechanical steps.²¹¹

belongs to the party that generated it and the law does not interfere with her use of the information. See, e.g., Rule 14e-3(a), 17 C.F.R. § 240.14e-3(a) (1995) (making it illegal for any person *other than the offering person* to trade on material inside information concerning the offering person's tender offer).

²¹⁰ See Coffee, *supra* note 35, at 1344-45 (noting that the SEC has failed to define when institutional support for a candidate for director will cause the institutions to be deemed constructive directors under a deputization theory, but reporting that the SEC will deem subject to § 16 investors who collectively control 10% or more of a class of the company's equity securities and who form a "voting group" that requires disclosure under the Williams Act).

²¹¹ One unattractive tactic for institutions would be to suspend trading in the company's stock so that six months will have elapsed by the time the purchaser in the auction closes the transaction and the institution would be deemed to have "sold" its stock for purposes of § 16(b).

Alternatively, proponents could restrict the group to persons holding only a little above 10% of the shares. After calling for the dissolution vote, they could sell enough stock to bring them below 10%, then "disband," thereby limiting the amount of disgorgement to "profits" on these last shares sold. For the legal theory behind this tactic, see *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418 (1972). In *Reliance Electric*, the original defendant sold the increment of stock above 9.96% in one transaction and the remaining 9.96% thereafter. The Supreme Court held that shareholders are liable for profits only while they own 10% of the stock. See *id.* at 420. Therefore, once a shareholder's holdings drops below 10%, the statute no longer applies. Thus, the only shares on which the *Reliance Electric* defendant could be liable were those bringing its holdings below 10%. See *id.*

Arbitrageurs could call for a dissolution vote with minimal fear from § 16(b) and with less public-relations distress than institutional investors. They could, for example, coordinate their purchases, assemble barely over 10% of the stock, and then call for the dissolution vote. Each investor could then sell its pro rata portion of the increment above 10% and sever communications with one another.

B. *Workable Solutions to Problems Created By Federal Securities Law*

1. Current Law

Recent changes by the SEC in its proxy rules simplify communication among shareholders.²¹² While not deregulating the process to the satisfaction of many commentators and large shareholders,²¹³ these changes give proponents serviceable means to put dissolution on the ballot without enmeshing them in prohibitive transaction and litigation costs.²¹⁴

The most practicable route for avoiding the obstacles created by federal securities laws is Rule 14a-1(l)(2)(iv). Rule 14a-1(l)(2)(iv) of the revised rules excludes from the category of "solicitation" published statements of how a securityholder intends to vote and the reasons for its vote, provided that the holder is not otherwise engaged in a proxy solicitation other than one exempt under Rule 14a-2.²¹⁵ A proponent would, therefore, have to take care that its

Naturally, as long as § 16(b) punishes holders of more than 10% of the corporation's securities, state legislatures should keep the threshold percentage for calling for a dissolution vote at no more than 10%.

²¹² For the adopting release, see Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, 57 Fed. Reg. 48,276 (1992). For description of the changes, see Fisch, *supra* note 187 (describing evolution of proxy rules, the impediments proxy rules created for intrashareholder communication, and the partial improvements effected by the 1992 amendments).

²¹³ See, e.g., Fisch, *supra* note 187, at 1197-99 (arguing that reforms do not go far enough); Robert S. Frenchman, *The Recent Revisions to Federal Proxy Regulations: Lifting the Ban on Shareholder Communications*, 68 TUL. L. REV. 161, 193 (1993) (urging that "nonbinding, publicly disseminated voting alliances made by otherwise unrelated shareholders" be excluded from the definition of "beneficial ownership" and "group" status).

²¹⁴ Prior to October 16, 1992, SEC rules defined "solicitation" very broadly. See Rule 14a-1(l)(iii), 17 C.F.R. § 240.14a-1(l)(iii) (1995); see also *Long Island Lighting Co. v. Barbash*, 779 F.2d 793, 796 (2d Cir. 1985) (holding that newspaper advertisements were not, as a matter of law, exempt from § 14(a) of the Securities Exchange Act and remanding the case to determine whether the advertisements were "reasonably calculated to influence the shareholders' votes"); *SEC v. Okin*, 132 F.2d 784, 786 (2d Cir. 1943) (holding that the SEC can regulate not only proxies but also "any other writings which are part of a continuous plan ending in solicitation"). Well-established caselaw subjected such communications (with some exceptions) to the proxy rules if they were "part of 'a continuous plan' intended to end in solicitation and to prepare the way for success." *Studebaker Corp. v. Gittlin*, 360 F.2d 692, 696 (2d Cir. 1966). In 1992, however, the SEC amended the proxy rules to remove some of the burdens from shareholder communications. These changes simplify communicating with other shareholders who also wish to propose dissolution. See Fisch, *supra* note 187, at 1165-70 (describing how the 1992 amendments to the rules make intrashareholder communication somewhat easier but still leave proxy regulation too complex and burdensome).

²¹⁵ Rule 14a-1(l)(2)(iv) provides:

communication does not contain material other than its reasons for voting to put dissolution on the ballot that could be construed as a proxy solicitation, unless it qualified for exemption under Rule 14a-2.

Under state law, shareholders can most easily call a dissolution vote by simultaneously presenting to management sufficient shareholdings to demand the vote. Rule 14a-1(l)(2)(iv)'s safe harbor for public announcements would allow the primary proponent to announce its intent to present its shares at a specified date and time at corporate headquarters in a demand for a dissolution vote. Upon this announcement, other shareholders also wishing to call a vote on dissolution would present sufficient simultaneous demands at corporate headquarters to force a dissolution vote.²¹⁶ Shareholders could then coordinate their actions without any two-way communication among them.

The proponent must take care not to make additional communications that could be construed as "*otherwise* engag[ing] in a proxy solicitation" and thereby losing the safe harbor.²¹⁷ Management will likely argue that identifying a time and place for demanding a dissolution vote not only conveys the proponent's views but creates a venue for shareholder action where none would otherwise exist. By creating this venue and stimulating this independent demand, the argument goes, the proponent is "*otherwise* engag[ing] in a proxy solicitation."

Such an argument stretches the already broad concept of "solicitation" beyond the breaking point. Under the hypothesis, the proponent will at no time solicit proxies from anyone. Other shareholders demanding a dissolution vote will do so on their own.

The terms ["solicit" and "solicitation"] do not apply, however, to: . . .

(iv) A communication by a security holder who does not otherwise engage in a proxy solicitation (other than a solicitation exempt under Rule 14a-2) stating how the security holder intends to vote and the reasons therefor, provided that the communication: (A) Is made by means of speeches in public forums, press releases, published or broadcast opinions, statements, or advertisements appearing in a broadcast media [sic], or newspaper, magazine or other bona fide publication disseminated on a regular basis

. . . .

17 C.F.R. § 240.14a-1(l)(2)(iv) (1995).

²¹⁶ Each shareholder should notify management in advance that it wishes its shares to be aggregated with those of the original proponent. In this way, each shareholder can communicate with management without implicating securities laws that would create obstacles to intrashareholder communication.

²¹⁷ Rule 14a-1(l)(2)(iv), quoted *supra* note 215 (emphasis added); see also *infra* notes 218-19 and accompanying text.

Later, at the actual shareholder vote on dissolution, the proponent will presumably only make the public announcement allowed in Rule 14a-1(l)(2)(iv). In the absence of any additional communications, the proponent clearly should fall within the boundaries of the safe harbor.²¹⁸

Indeed, although Rule 14a-1(l)(2)(iv) allows the proponent to state her reasons for demanding a dissolution vote, the proponent could even forego stating her reasons and communicate only her intent to make a dissolution demand on such and such a date and time. Other shareholders will independently decide whether they want to demand a vote without needing the proponent's reasoning. By omitting her reasons, the proponent would demonstrate that other stockholders based their own dissolution demands to management on their own analysis and not on the proponent's claims.²¹⁹

²¹⁸ Courts have construed "solicitation" to include material not directly soliciting proxies only if the proponent intends to solicit proxies or authorizations at some point in the process. The broadest interpretation of "solicitation" occurred in *Okin*, 132 F.2d 784. The dispute in *Okin* concerned whether the proxy rules applied to a letter sent by dissident Okin "to shareholders asking them not to sign any proxies for the company, and to revoke any which they might have already signed." *Id.* at 786. Okin planned later to oppose management and make his own solicitation to the shareholders. *See id.* The court held that the proxy rules regulating proxy solicitations applied specifically to Okin's letter and generally to "any other writings which are part of a continuous plan ending in solicitation and which prepare the way for its success," as well as to formal proxies, powers of attorney, consents, or authorizations. *Id.* Noting that by itself the letter would not have constituted a solicitation, the court stated that "[i]f the complaint had not alleged that the defendant intended to follow [the letter] up by actually soliciting proxies, . . . we should indeed have great doubt whether it stated a cause of action." *Id.*

Similarly, in *Studebaker*, 360 F.2d at 694, dissident Gittlin announced that he intended to solicit proxies in opposition to management if management failed to take certain actions. Thus, his communications with the other 42 *Studebaker* shareholders to amass the five percent required to force *Studebaker* to turn over its shareholder list also constituted "part of 'a continuous plan' intended to end in solicitation and to prepare the way for success." *Id.* at 696 (quoting *Okin*, 132 F.2d at 786). As the court noted in quoting the SEC's amicus brief, the protective provisions of the proxy rules were intended to reach "situations in which a stockholder is requested to *permit another to act for him*." *Id.* at 696 n.2 (emphasis added).

In the dissolution context, the proponent will presumably not intend to ask another to permit her to act for the other. *See supra* note 191. Thus, in the absence of any intent to solicit proxies later in the process, a proponent who merely avails herself of the right to solicit up to 10 solicitees or to make a public announcement of her position or both should not be considered to be otherwise engaged in a proxy solicitation for the purposes of Rule 14a-1(l)(2)(iv).

²¹⁹ Although *Studebaker* involved a plan to later solicit shareholders and is, therefore, not directly on point, the *Studebaker* court articulated a rationale that

Several benefits flow from using Rule 14a-1(l)(2)(iv)'s exempted public announcement rather than two-way communications. None of the parties presenting their shares on the appointed day will make any *agreement* (indeed, they likely will not even have communicated) with any other. Consequently, they will not constitute a group and will not be liable under section 13(d) or section 16(b) of the '34 Act. Further, because under Rule 14a-1(l)(2)(iv) the published announcement is not a solicitation, the communication is not subject to the proxy rules, and management cannot sue under Rule 14a-9, claiming misrepresentation.

Proponents should formally notify management well before the special or annual shareholder meeting that they intend to call a vote on dissolution at the meeting. Under current case law, management would have to put the issue on the ballot. Management may wish not to include the proposal, but thus far authorities have not allowed such a degree of shareholder disenfranchisement.²²⁰ Once the issue is on the ballot, shareholders who expect a premium-yielding auction can vote to dissolve without needing to campaign.

management would likely use to urge repeal or amendment of Rule 14a-1(l)(2)(iv). The court noted that "[p]resumably the [42] stockholders who gave authorizations [in order to demand a shareholders list under New York law] were told *something*." *Studebaker*, 360 F.2d at 696 (emphasis added). Where shareholders are willing to make a special trip to the corporate headquarters to demand a dissolution vote after learning nothing more than the fact that another shareholder intends to do the same, any fear that they are threatened by misleading or inadequate disclosure is unfounded.

²²⁰ Management has, for example, sought to omit the dissident's proposal from the proxy while claiming that the form of proxy conferred discretionary authority on management to vote against the dissident's proposal, even though shareholders other than the proponent were unaware of the proposal's existence and were presented with no boxes in which to vote on it. Courts have ruled such practices invalid, however, in instances in which the proponent gives management adequate notice. *See United Mine Workers, Local 7950 v. Pittston Co.*, Fed. Sec. L. Rep. (CCH) ¶ 94,946 (D.D.C. Nov. 24, 1989) (holding that management did not have discretionary authority to vote proxy cards against dissident proposals when management, having had adequate advance notice of the proposals, refused to include in its proxy materials meaningful disclosure to shareholders regarding the proposals); *see also Grimes v. Centerior Energy Corp.*, 909 F.2d 529, 533 (D.C. Cir. 1990) (stating that "the omission of a proposal *not* properly excludable under Rule 14a-8(c) will necessarily be misleading under Rule 14a-9" (citing *New York City Employees' Retirement Sys. v. American Brands, Inc.*, 634 F. Supp. 1382 (S.D.N.Y. 1986)), *cert. denied*, 498 U.S. 1073 (1991)).

2. Possible Improvements

Shareholder proponents should be able to debate with management on a level playing field, one that allows genuine debate and that does not force shareholders to use legalese pabulum that ultimately stupefies, rather than enlightens, the reader.²²¹ Current SEC restraints ultimately favor management: where confused, shareholders will either vote with management or abstain. Abstentions count as votes against dissolving the company. Thus, there is little reason to fear that shareholders will be confused into voting for dissolution. Management can try to dissuade shareholders from approving dissolution, and the SEC will punish wilful misdisclosure by dissolution proponents. Accordingly, the SEC should (a) confirm that shareholders can use Rule 14a-1(l)(2)(iv)'s exemption both to call for a vote on dissolution and to signal how and why they are going to vote, (b) otherwise liberalize the '34 Act to reduce burdens on legitimate shareholder action, and (c) ultimately, allow shareholders to use Rule 14a-8.²²²

²²¹ For an amusing, if dispiriting, example of SEC comments on dissidents' proxy material that amounted to pro-management censorship, see Bernard S. Black, *Disclosure, Not Censorship: The Case for Proxy Reform*, 17 J. CORP. L. 49, 77-85 (1991) (reproducing punishingly fastidious SEC requests for changes and qualifications to dissident's proxy statement that effectively silenced the dissident), excerpted in John C. Coffee, Jr., *Proxy Contests: The Shape of the Future*, N.Y. L.J., Oct. 1, 1992, at 6.

²²² If SEC rules really worked to promote investor communication, shareholders holding sufficient shares would be able to use Rule 14a-8 to call for a dissolution vote. Although the SEC has created a list of 13 categories of proposals that management may omit, the list is supposed simply to spare corporations the nuisance and expense of proposals that are not appropriate for shareholder action. See 17 C.F.R. § 240.14a-8(c)(1)-(13) (1995).

In fact, the SEC has read Rule 14a-8's exclusions consistently to defeat shareholder attempts to cause dissolution votes. For example, in *De Anza Properties-X*, the SEC agreed with management to eliminate the proposal on the grounds that it was necessary to protect shareholders from "confusion," despite dissidents' express willingness, in order to eliminate any confusion, to disallow limited partners from voting on the dissidents' proposal unless they first either voted "no" or abstained on management's proposal. See *De Anza Properties-X*, SEC No-Action Letters, 1989 SEC No-Act. LEXIS 796 & 812 (July 11 and 12, 1989).

In the shareholders' attempt to request the dissolution and liquidation of Tri-South Investments, Inc., the dissidents invited management to print in its proxy materials a statement to the following effect:

IF YOU FAVOR THE MERGER PROPOSAL, THEN MARK YOUR PROXY ACCORDINGLY AND DO NOT MARK YOUR PROXY IN FAVOR OF THE WITHIN SHAREHOLDERS' PRECATORY REQUEST. CONVERSELY, IF YOU FAVOR THE SHAREHOLDERS' PRECATORY REQUEST, THEN DO NOT MARK YOUR PROXY IN FAVOR OF THE MERGER PROPOSAL. IF YOU VOTE FAVORABLY FOR THE MERGER

VI. OPTING OUT OF THE DISSOLUTION REGIME: THE QUINQUENNIAL ELECTION

Because votes on dissolution are not without cost, the law should erect reasonable constraints that will guarantee that dissolution will not unduly burden corporations, while at the same time guaranteeing shareholders a realistic right to use dissolution. First, because the transaction costs of dissolution votes can be high, the law should require a moderately high percentage of shares to initiate such a vote. In addition, the law should allow shareholders to elect to forego, for specified periods, voting on dissolution. This Part discusses why dissolution votes might burden corporations and describes a regime that would allow shareholders to opt out of such elections for up to five years without relinquishing the primary benefits of dissolution.

Under this scheme, shareholders' decisions about dissolution would operate on three different levels: (1) *whether to waive the ability to vote* on dissolution for the next five years, thereby temporarily "opting out" of dissolution, (2) if the shareholders have not waived this ability, *whether to conduct a vote* to dissolve, and (3) in the event of an actual vote, *whether to dissolve* the corporation. This regime would allow shareholders of well-managed companies to benefit from the dissolution regime as a remote background threat against a possible decline in quality without undergoing actual dissolution votes, while giving shareholders in less well-managed companies a more immediate means for encouraging managerial improvement via dissolution votes that can be called at any time.

PROPOSAL AND FOR THE PRECATORY REQUEST OF THE PROPO-
NENTS, THEN YOUR PROXY WILL BE TREATED AS A VOTE IN
FAVOR OF THE MERGER PROPOSAL AND YOUR INCONSISTENT
VOTE IN FAVOR OF THE PRECATORY REQUEST WILL BE TREATED
AS A NULLITY.

Tri-South Investments, Inc., SEC No-Action Letter, 1985 WL 53924, at *5 (Mar. 6, 1985). Given proponents' care to avoid confusion, it is difficult to see how the SEC's implementation of Rule 14a-8 squares with its purported objective of fair and complete disclosure and meaningful corporate suffrage.

For similar No-Action letters, see Banyan Strategic Land Trust, SEC No-Action Letter, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,252 (May 28, 1992); May Petroleum Inc., SEC No-Action Letter, 1988 WL 234049, at *5 (Jan. 29, 1988).

A. *The Costs of the Dissolution Regime*

The present proposal benefits shareholders to the extent that they use dissolution only when management has mismanaged the corporation to the point that auctioning the corporation's assets will improve shareholder wealth.²²³ Critics could claim that the dissolution regime will distract good, as well as underperforming, management, forcing them to divert valuable resources in order to convince shareholders to vote against dissolution. Where a dissolution vote is unwarranted, the dissolution regime could have the effect of a nuisance suit, albeit one that management cannot settle but must conduct to its conclusion.

To the extent that the stock market efficiently values stock, the greatest disparity between actual and potential prices will result from the existence of inefficient management. Theoretically, the stock price of a well-managed corporation should approximate its potential maximum. Any disparity should be small, and dissolution should not be a realistic threat. Inefficient managements, on the other hand, will have allowed greater disparities and should draw pressure to improve their performance. Such managements should pay attention to market reactions to their activities and announced plans.²²⁴ To the extent that dissolution discourages value-reducing

²²³ Similarly, contests for corporate control have also been rare, relative to total merger activity. See Jensen, *Modern Industrial Revolution*, *supra* note 17, at 837 (noting that of the 35,000 mergers and acquisitions transactions occurring from 1976-1990, only 364 of these offers were contested and of those only 172 resulted in hostile takeovers).

²²⁴ Indeed, such managements should use the market's reaction as a "trial balloon" before they solidify major investment plans, in the same way political professionals in Washington use preliminary "leaks" to test public reaction before actually making legislative proposals. Post-leak movement in the firm's share price will convey the market's verdict on the proposal, allowing management to abort those proposals that would reduce shareholder value.

For an analogous proposal in the context of bidding for acquisition targets, see Wilbur G. Lewellen & Michael G. Ferri, *Strategies for the Merger Game: Management and the Market*, FIN. MGMT., Winter 1983, at 25, 34-35. Lewellen and Ferri present an ex ante strategy for bidding in which management can use the pre-bid ratio of the two companies' market prices to construct an initial bid and use the market's reaction to gauge the value of synergies and, therefore, the bid's upper limit. As with the present proposal, they note that where the bidding company's stock declines on news of the bid, the transaction should be aborted. See *id.* at 33-34; see also George W. Dent, Jr., *Unprofitable Mergers: Toward a Market-Based Legal Response*, 80 NW. U. L. REV. 777, 794 (1986) (arguing that courts should "enjoin as corporate waste or a breach of fiduciary duty any acquisition the disclosure of which causes a material decline in the price of the proposed buyer's common stock"). Although Professor Dent is correct to rely on market signals as to the wastefulness of certain acquisitions,

behavior, it will save, not waste, corporate resources.

Nevertheless, the possibility of shareholder-forced auctions clearly puts at risk managers' jobs and the value of their expertise in running S. Management, not unreasonably, will demand compensation for this increased risk to their firm-specific human capital.²²⁵ To the extent that society adopts more efficient mechanisms for displacing inefficient management, displaced management *should* receive compensation for surrendering its control over the corporation.²²⁶

Dissolution might, at least initially, harm other corporate constituencies—creditors, workers, communities, suppliers, and customers. To an even greater extent than management, they cannot know, when they make their firm-specific investments in the corporation, whether management will act so as to reduce shareholder value, thereby increasing the likelihood of dissolution. They may then demand a premium to compensate them for any such added risk, thus raising the corporation's cost for financing, labor, and supplies.²²⁷

relying on dissolution to punish such waste would be more "market-based" than his solution and would also involve fewer difficult interpretive problems.

²²⁵ See, e.g., Coffee, *supra* note 1, at 1236-37. Coffee fears that exposure to external disciplining by takeovers would cause competent managers to exit or to decline to join the "inefficiently managed" firm. *Id.* A *fortiori*, dissolution would raise the same concern.

²²⁶ One of the benefits of the agency cost literature is that it places greater weight on realistic assessments of human conduct and less weight on moralistic assessments. For important explorations of issues concerning agency costs, see, e.g., PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS (John W. Pratt & Richard J. Zeckhauser eds., 1985); Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271 (1986); Fama, *supra* note 80; Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327 (1983); Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323 (1986); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

Agency costs reflect the divergence of interests between management (the agent) and the shareholders (its beneficiaries). To the extent that society can find mechanisms to better align the interests of management and shareholders, these mechanisms will expand wealth. Paying managers increased compensation in exchange for their increased willingness to relinquish control over corporate assets is a comparatively low cost method of redeploying assets. Almost by definition, in order to have won its position, management has succeeded in the quite competitive market for executive services. To impose a regime that would reduce the rewards for climbing the corporate hierarchy is to reduce the incentives for skilled persons to participate in that market. Managers who have ascended to top positions have certain expectations about the rewards for their success, as do, more importantly, those who look to follow them. Generously compensating managers displaced by dissolution works the least damage on their and their successors' expectations.

²²⁷ See, e.g., Sheridan Titman, *The Effect of Capital Structure on a Firm's Liquidation*

If dissolution were to impose any costs, it would do so only once, as parties adjust to the new regime. Over the long-term, dissolution should lower these costs by making companies healthier. Viewed statically, creditors, workers, and others would worry that shareholders would vote frequently for dissolution, unmindful of the impact on other constituencies and concerned solely with recouping part of the value of the disparity. Viewed dynamically, however, the threat of dissolution would likely discipline managers who would not otherwise maximize the corporation's value, forcing them to manage better. Thus, after dissolution becomes a powerful source of discipline, managements would take the necessary steps to maximize corporate value, thereby *preventing*, rather than just reducing, significant disparities. Such improved discipline would reduce the volatility of the company's cash flows, thereby decreasing risks to creditors, employees, and the like. Ultimately, they, like the shareholders, would be better off.

An optimal dissolution regime should elicit improved monitoring while keeping costs to a minimum. Forcing shareholders of well-managed corporations to vote on dissolution would be wasteful. Furthermore, even where management may not be optimal, shareholders may wish to give management wide discretion, free from the threat of dissolution. Consequently, the proposed scheme creates provisions for shareholders to voluntarily waive shareholder-initiated votes on dissolution for periods of up to five years.

B. *The Quinquennial Opt-Out Election*

The opt-out mechanism would operate as follows: every five years, shareholders would choose either to waive or to retain the right to vote for dissolution during the upcoming five-year period. The default position will be an opt-out: unless an affirmative majority of disinterested (non-management affiliated) shareholders votes to retain the right to initiate dissolution, shareholders will be deemed to have opted out of the dissolution regime and will not be able to initiate dissolution for the following five-year period.²²⁸ If shareholders "opt in" by retaining the right to initiate dissolution, they may initiate dissolution at any time during the following five-

Decision, 13 J. FIN. ECON. 137, 138-39 (1984) (stating that liquidation imposes "increased maintenance costs" by increasing customers' reluctance to buy the firm's products due to concern that the firm may discontinue operations).

²²⁸ Naturally, the board would at all times retain the right to initiate a vote to voluntarily dissolve the corporation.

year period. During this period, shareholders holding, say, twenty percent of the outstanding shares could call a special meeting, and shareholders holding ten percent could call for a dissolution vote at any annual meeting. If holders of the required percentage of shares call for an actual dissolution vote, shareholders will vote whether to dissolve.²²⁹

Management can win the quinquennial election to "opt out" of dissolution simply and inexpensively in many, perhaps most, cases. First, management's control of the proxy machinery and normal shareholder inertia favor management. In the absence of some party affirmatively soliciting shareholders to opt in or some market movement that encourages shareholders to do so, shareholders will hear only management's side of the argument.²³⁰ Shareholders favoring opting in will have to finance their own recommendations. Thus, corporations will opt into the dissolution regime only in exceptional circumstances where shareholders can clearly benefit: where proponents of dissolution are both disgruntled and capable of convincing other shareholders to opt in or where stock price movements reflect the market's perception that a significant disparity exists or will exist in the next five years.

²²⁹ For similar proposals for allowing periodic shareholder votes, see Coffee, *supra* note 1, at 1262-63 (recommending requiring supermajority provisions to be renewed every three years by a shareholder vote of similar magnitude); *id.* at 1281 (describing the SEC's Advisory Committee on Tender Offers' recommendation requiring supermajority provisions to be renewed every three years by a shareholder vote); Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 224-36 (1991) (proposing mandatory five-year moratoria on hostile takeovers with quinquennial, rather than annual, shareholder elections allowing changes in control); Romano, *supra* note 17, at 165-66 (proposing, among other reforms, amending the Williams Act to allow shareholders to opt out of the Act's coverage if they do not wish the firm to hold auctions, thereby encouraging more takeover bids, though perhaps at lower premiums). The current proposal obviously shares more in common with Romano's or Coffee's proposal than with Lipton and Rosenblum's. The latter proposal is unappealing because it follows essentially a socialist, or at least command economy, model for running free market firms, proposing that management run the corporation according to five-year plans. See Lipton & Rosenblum, *supra*, at 225-27. Reducing directors' discretion to respond to changing conditions would discard the dynamic responsiveness of capitalist forms of organization.

²³⁰ Clearly, shareholders are unlikely to campaign for opting into dissolution unless there exists some credible evidence that the right to vote annually on dissolution will, in fact, be valuable. Counsel to management will articulate all the costs that opting in will impose on the corporation. Shareholders will understand that the costs of the annual vote on dissolving the corporation falls on them. As such, where there is little reason to expect a disparity that would justify forcing an auction, shareholders will see opting into the dissolution regime as wasteful.

Similarly, management will have the advantage in any actual vote on dissolution itself. Management must put dissolution to a vote only if the required percentage of the shares (ten percent, twenty percent) so requests. Collective action problems work against shareholders expending such resources. Shareholders bear the actual costs of bringing the issue to a vote, plus their pro rata share of any loss in *S*'s value owing to transaction costs of the vote itself. Thus, proponents' interests align with those of the other shareholders; they will trigger a dissolution vote only when the expected returns to all shareholders are exceptionally high.²³¹ Active shareholders can learn from experience when dissolution is most likely to benefit them. To the extent that earlier shareholder-induced dissolutions of other corporations fail to create gains for shareholders, shareholders will have less incentive to call for a vote on dissolution. Significant dissolution-induced premiums, on the other hand, will build credibility for forcing auctions.

Shareholders, however, should be able to "opt out" only for limited periods. Without periodically recurring shareholder votes, management could take advantage of collective action problems and freeze shareholders permanently out of the dissolution regime.²³²

²³¹ One potential objection to the perfect alignment of interests of dissolution proponents and other shareholders is the possibility that a large shareholder would threaten management with initiating a dissolution vote in order to be bought off by managers, similar to being paid greenmail for withdrawing a hostile takeover. For the problem generally, see Jeffrey N. Gordon, *Shareholder Initiative: A Social Choice and Game Theoretic Approach to Corporate Law*, 60 U. CIN. L. REV. 347, 381-84 (1991) (describing how shareholders can "pursue private wealth maximization" by threatening a shareholder initiative). Such side-deals between management and dissident shareholders would be much less likely in the dissolution context than in either a greenmail or a shareholder-initiative context. Greenmail payments could stave off management displacement only because takeovers are so difficult to launch. Management could gamble that once the greenmailer was gone, no other bidders would emerge. Dissolution, by contrast, would eliminate much, if not all, of the expenses of displacing management. Accordingly, management's repurchase of the stock of a shareholder threatening dissolution will only increase the disparity; other dissolution proponents could (and would) arise with relative ease. Specific shareholder initiatives, on the other hand, require complicated calculations involving strategic planning and valuation and are likely to be based on relatively private information not available to other shareholders. It is one of the theses of this Article, however, that many market participants will know of the existence of substantial disparities, making it impossible to buy off all potential dissolution proponents.

²³² The SEC's Advisory Committee on Tender Offers proposed a similar requirement respecting supermajority provisions. There the fear was that management would paralyze shareholder action by requiring supermajority votes that could never realistically be obtained. Under the Advisory Committee's proposal, shareholders would have had to approve supermajority provisions by the same level of shareholder

Such a permanent waiver is unnecessary for able management, whose shareholders will vote repeatedly to opt out of the scheme. Therefore, shareholders opting out of the dissolution provision should have to ratify this decision every five years.²³³

CONCLUSION

Optimal corporate laws improve the efficiency and fairness of the conduct of business. One best secures the efficiency and fairness of corporate law, as of market economies and democratic societies generally, by giving contending parties the ability to pursue their interests, effectively but without wrongfully coercing others, against the noncoercive resistance of competing interests. Currently, corporate law's tilt against hostile takeovers hinders shareholders from directly replacing corporate managers, their putative agents. Instead, shareholders must rely on infrequent proxy fights, infrequent intervention by independent directors, and takeovers that occur less frequently than shareholders prefer. Dissolution constitutes the most elegant means for shareholders directly to displace inefficient management, by letting them, uncoerced by bidders or by management, compel poorly run companies to be auctioned.

Both shareholders and non-shareholder constituencies would benefit from the use of voluntary dissolution to discipline management. Dissolution already stands ready to be used in several commercially important states, including New York, California, and Illinois.²³⁴ Most states, however, including Delaware, do not give shareholders the right to initiate voluntary dissolution.²³⁵ Therefore, the "reform" position is for states that do not currently give shareholders that right to do so and let the self-regulating processes of voluntary dissolution winnow inefficient managements and impose heightened managerial discipline.²³⁶

approval as the provisions would require to approve a transaction. They would also have to renew these provisions every three years. See Coffee, *supra* note 1, at 1253 nn.328-29, 1263 n.356 (referring to Advisory Committee on Tender Offers, U.S. Sec. & Exch. Comm'n, Report of Recommendations 141 (July 8, 1983), recommendation 36, at 36-37).

²³³ Such a regime of five-year elections would parallel the regime proposed by Lipton & Rosenblum, *see supra* note 229, with the difference that shareholders could give themselves the right to choose dissolution between quinquennial elections.

²³⁴ See *supra* note 13.

²³⁵ See *supra* note 12.

²³⁶ The two most important practical reforms would be (a) for states, including

Can such a reform occur immediately? Perhaps not. But the reform can occur. Minority shareholders in close corporations have protections today that took many years to obtain. The history of involuntary judicial dissolution to protect close corporation minority shareholders from oppression demonstrates that even when reforms are slow in coming, they are worth pursuing. In 1940, the idea of using involuntary judicial dissolution to protect minority shareholders was so novel that George Hornstein felt it necessary to explain why courts *could* legitimately take such action.²³⁷ In 1952, courts continued to construe statutes permitting judicial dissolution to remedy deadlock so narrowly that, in order to spur more liberal use of judicial dissolution, Carlos Israels disparaged the corporate entity's hallowed status as a "sacred cow."²³⁸ Yet by the mid-1960s, minority shareholder proponents could point to courts' greater willingness to use involuntary dissolution to curb oppression, while pressing for expanding the remedy still further.²³⁹ In 1975, in the first edition of his influential *Oppression of Minority Shareholders*, Professor F. Hodge O'Neal began urging courts to adopt the "reasonable expectations" standard for judging proper

Delaware, that currently allow shareholder-initiated dissolution to be effectuated by unanimous shareholder action to allow it to be effectuated by holders of a majority of the shares and (b) for the next iteration of the RMBCA and states following the RMBCA paradigm to amend § 14.02 to allow shareholders to initiate dissolution by majority vote. The change in (a) would make shareholder-initiated voluntary dissolution available in the following states where, realistically speaking, it is currently unavailable: Alabama, Arizona, Delaware, Hawaii, Idaho, Missouri, Nebraska, New Jersey, New Mexico, Oregon, Rhode Island, Tennessee, Texas, and West Virginia. *See supra* note 12. The change in (b) would make dissolution available in the following 10 states that currently follow the RMBCA model: Alabama, Georgia, Iowa, Mississippi, New Hampshire, North Carolina, Utah, Washington, Wisconsin, and Wyoming. *See supra* note 12. If these two changes were to be made, the current situation would be reversed, and only the following 13 states would deny shareholders the right to initiate dissolution: Colorado, Connecticut, Indiana, Kansas, Maryland, Michigan, Montana, Nevada, New Hampshire, Oklahoma, Pennsylvania, South Dakota, and Virginia. *See supra* note 12.

²³⁷ See George D. Hornstein, *A Remedy for Corporate Abuse—Judicial Power to Wind Up a Corporation at the Suit of a Minority Stockholder*, 40 COLUM. L. REV. 220, 236, 249-51 (1940).

²³⁸ Carlos L. Israels, *The Sacred Cow of Corporate Existence: Problems of Deadlock and Dissolution*, 19 U. CHI. L. REV. 778, 778 (1952).

²³⁹ See Comment, *Oppression As a Statutory Ground for Corporate Dissolution*, 1965 DUKE L.J. 128, 138 (discussing the benefits of "liberalizing the remedy of dissolution"); Note, *Dissolution of the Close Corporation*, 41 ST. JOHN'S L. REV. 239, 255 (1966) (arguing for the use of dissolution to protect minority shareholders of close corporations facing "controvers[ies] involving the personal relationship between individuals").

treatment of dissenting minority shareholders.²⁴⁰ By the 1980s, this standard had found widespread judicial acceptance.²⁴¹ In 1983, Minnesota became the first state explicitly to adopt legislation including "reasonable expectations" as a standard for judicial dissolution, followed by North Dakota in 1986.²⁴² Thus, although minority shareholders had to wait decades for judicial dissolution to be shaped into an effective remedy, the reform eventually occurred.

Now that minority shareholders in close corporations have meaningful protections, "minority"²⁴³ (i.e., non-management) shareholders in public corporations are the next logical constituency for the remedy of dissolution. Managerialists will likely employ the rhetoric used against takeovers to decry this use of voluntary dissolution. Voluntary dissolution's inherently uncoerced nature, however, precludes managers from justifying their opposition by claiming that they are "protecting" shareholders. Given the voluntary nature of dissolution and the fact that it requires approval by an affirmative majority, any managerial opposition to dissolution must derive from a desire to deprive shareholders of the choice to specify the end, as well as the beginning, of their collective investment in the corporation.

For the law to allow shareholders to interfere in the day-to-day conduct of the corporation's business and affairs is to hurt shareholders. Thus, protecting management with the business judgment rule against shareholder complaints normally increases shareholder welfare. Nevertheless, for the law to allow the shareholders' agents to preclude their principals, as a group, from cashing out their investment when they collectively wish to do so is to abandon the principle that the shareholder-principals, rather than the manager-agents, are the true beneficiaries of corporate law.

²⁴⁰ See Thompson, *Shareholders' Reasonable Expectations*, *supra* note 41, at 193 (noting that O'Neal's treatise advocated the reasonable expectations test as "the most reliable guide to a just resolution of disputes among shareholders").

²⁴¹ See *id.* at 213 (listing states that have adopted a "reasonable expectations" standard).

²⁴² See *id.* at 215.

²⁴³ See *supra* note 25 and accompanying text (illustrating how management can treat public corporation shareholders holding more than 90% of the company's stock as peremptorily as insiders treat minority shareholders in close corporations).